STUDY

Requested by the REGI committee

European Parliament

Research for REGI Committee - Control and simplification of procedures within ESIF

Policy Department for Economic, Scientific and Quality of Life Policies

Directorate General for Internal Policies of the Union

PE 601.972 - April 2018

EN

DIRECTORATE-GENERAL FOR INTERNAL POLICIES

Policy Department for Structural and Cohesion Policies

REGIONAL DEVELOPMENT

Research for REGI Committee -Control and simplification of procedures within ESIF

STUDY

Abstract

This study assesses the relationship between two components of European Structural and Investment Funds – control and audit systems, and simplification measures designed to reduce the complexity of implementation – and explores how this relationship conditions performance. It sets out financial control and audit systems and tasks in 2014-2020, and assesses the causes of complexity before exploring how issues are being addressed in the simplification agenda. The study reviews the treatment of control and simplification in the post-2020 debate before drawing together conclusions and recommendations for ESIF stakeholders.

IP/B/REGI/IC/2017-051 April 2018

PE 601.972 EN

This document was requested by the European Parliament's Committee on Regional Development.

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LINGUISTIC VERSIONS

Original: EN

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Manuscript completed in April 2018

Print	ISBN 978-92-846-2658-8	doi:10.2861/285460	QA- 02-18-170-EN-C
PDF	ISBN 978-92-846-2659-5	doi:10.2861/524513	QA- 02-18-170-EN-N

This document is available on the internet in summary with option to download the full text at:
http://bit.ly/2HJcvhr

For full text download only:
http://www.europarl.europa.eu/RegData/etudes/STUD/2017/601972/IPOL_STU(2017)601972_EN.pdf

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Please use the following reference to cite this study:
Ferry, M & Polverari, L, 2018, Research for REGI Committee – Control and simplification of procedures within ESIF, European Parliament, Policy Department for Structural and Cohesion Policies, Brussels
Please use the following reference for in-text citations:
Ferry & Polverari (2018)

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LIST OF ABBREVIATIONS

AA(s)	Audit authority(/ies)
CA(s)	Certifying authority(/ies)
CF	Cohesion Fund
COSME	Competitiveness of Enterprises and Small and Medium-sized Enterprises
CP	Cohesion policy
CPR	Common Provisions Regulation
CSF	Common Strategic Framework
DG EMPL	Directorate-General for Employment, Social Affairs and Inclusion
DG REGIO	Directorate-General for Regional and Urban Policy
EC	European Commission
ECA	European Court of Auditors
EIB	European Investment Bank
EFSI	European Fund for Strategic Investments
ERDF	European Regional Development Fund
EP	European Parliament
ESF	European Social Fund
ESIF	European Structural and Investment Funds
ETC	European Territorial Cooperation
FI	Financial Instrument
IB(s)	Intermediate Body(/ies)
JASPERS	Joint Assistance to Support Projects in European Regions
MA(s)	Managing Authority(/ies)
MFF	Multiannual Financial Framework
MP(s)	Major project(s)
MS(s)	Member State(s)
OP(s)	Operational Programme(s)
ROP	Regional Operational Programme
SCO	Simplified Cost Options
SF	Structural Funds

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EXECUTIVE SUMMARY

Introduction: Aims of the study and research questions

This study assesses the relationship between two components of European Structural and Investment Funds (ESIF) – control and audit systems, and simplification measures designed to reduce the complexity of ESIF implementation – and explores how this relationship conditions ESIF performance.

The research included four specific aims:

- To provide an **overview of ESIF control and audit systems**.
- To **analyse control and audit provisions in 2014-20** in terms of their contribution to simplification.
- To assess the **role of the European Court of Auditors (ECA)**, including specific features of their audit approach.
- To **develop insights for** the development of control and audit arrangements that enhance the pursuit of simplification and improved ESIF performance in **the post 2020 period.**

The methodology combined desk-based research, interviews at EU and MS levels, and seven case studies from a mix of ESIF programmes from across the EU.

Control and audit in the simplification agenda: what is working?

The CPR introduced a number of measures to simplify procedures and reduce the complexity of financial control and audit. Nevertheless, in 2017 the **European Commission and the European Parliament restated the need to reconsider arrangements for simplifying control and audit.**

Responses from programme authorities have recognised the need for effective rules in order to avoid errors, fraud and the misuse of funds and welcomed the basic principles on which these measures are based. Nevertheless, **OP authorities continue to call for greater simplification of OP financial management and proportionality in audit and control**.

A key underlying theme in the debate on the future of Cohesion policy is **the need to reduce the costs of administering the funds while retaining the positive trend in the reduction of error rates.** Basic questions are whether and how a differentiated approach could be designed that moves away from the one-size-fits-all model of shared management and which recognises that different models may be appropriate for different contexts.

Conclusions and recommendations

The **current ESIF management and implementation system has been working effectively in driving errors and irregularities down**. The problem is essentially one of efficiency (cost). While the costs of the current control and audit system are problematic, there is still a need for checks to be carried out to ensure that rules are respected.

Substantial simplification has yet to be realised. A significant problem is the lack of stability and consistency in regulatory frameworks. Further, a substantial portion of the complexity of administering ESIF relates to rules that are outside the sphere of Cohesion policy (e.g. relating to state aid and public procurement).
Key simplification measures have not always been effective in reducing complexity and administrative burden:

- One aim of the **designation process** was to give increased scope for simplification with MS given the option to carry out the process without direct Commission review. However, many MS opted to have a 'heavier' approach due to concerns that future audits and controls would identify errors.

- The **'rolling closure'** process presents some challenges for programme authorities and is seen to create an additional administrative burden, as well as an increased risk of error.

- **Risk-based methods of sampling** for controls are viewed as beneficial by MAs, but AAs tend to underline the importance of retaining statistical sampling to maintain the necessary level of confidence in the audits realised.

- The **'Single Audit' model** is seen by programme authorities to have potential in terms of simplification. However, there is a need for more clarity on how and when an auditor can rely on existing findings.

- **Simplified cost options** are welcome but need to be further developed.

- '**Once only' audit for small operations** is useful in principle but defining 'small' is problematic in practice. Further tailoring could use a risk-based approach.

The research highlights a number of general principles for the future in order to reduce complexity, while continuing to drive errors and irregularities down. In deciding the emphasis to be placed on different principles, clear choices have to be made on the ultimate goals of simplification and the types of actors simplification efforts should target:

- **Harmonisation.** Genuine simplification must begin with greater harmonisation of rules across Commission services, funds and instruments. This highlights the role of EU initiatives in this field, including the Better Regulation Agenda and the REFIT Platform.

- **Stability.** More stability from one programme period to the next and better predictability for programme authorities and beneficiaries would simplify implementation, cut the times and costs of adaptation, and reduce the risk of errors and irregularities.

- **Brevity.** There should be single texts, made available to programme authorities in a timely manner, rather than a proliferation of rules and interpretations. This would enable better coordination between different actors and the timely identification of administrative capacity gaps.

- **Trust and capacity building.** The Commission has tried to introduce simplification by increasing the scope for flexibility and proportionality in control and audit fields. However, lack of trust and/or capacity have constrained take up of these options. Thus capacity-building activities should be implemented to enhance implementation efficiency in the longer term.
- **Flexibility and differentiation.** Complexity affects all MS, but it has distinctive dimensions in different MS and OP contexts. Especially where the scale of ESIF is small, complexity can create disproportionate administrative workloads and lead potential beneficiaries to pursue alternative funding opportunities. There is considerable debate about a more flexible, differentiated approach to control and audit that reflects variation in scale of funding, regularity of spending, administrative

capacity etc. However, practical questions remain about what would be suitable objective criteria for differentiation.

- **Appraisal, to avoid unintended consequences.** A number of valuable simplifications have already been introduced but their benefits have been undermined by new requirements which generated further complexity. It is paramount that the impact on administrative cost and burden of any reform proposal is carefully appraised and compared with the benefits associated with retaining the current rules and systems.

- **Timing.** Commission and programme authorities, including AAs, are being asked to make proposals for the future over the next few months. However, due to delays in programme implementation, they have little evidence to assess what is and is not working. All involved should take a longer-term view in appraising what works and what doesn't.

- **Role of the European Commission**. Continued pursuit of simplification initiatives, reviewing and revising current regulations, including the HLG on Simplification, 'Better Regulation Agenda' and the REFIT Platform and support of capacity-building initiatives in MS to strengthen simplification (e.g. in the take up of SCOs, extension of the 'Single Audit' etc.).

- **Role of ECA**. The ECA is crucial in balancing the need for legality and regularity of expenditure with the need for simplification. Current initiatives to strengthen cross reliance with the Commission and MS should be further developed.

- **Role of Member States.** It is important that MS play an active part in reducing complexity, by reviewing domestic choices that can have an impact on complexity, e.g. 'gold-plating', number of OPs implemented, design of programme management systems etc.

- **Performance auditing.** The spread of performance audits and their use in making financial decisions should be further pursued at EU and MS levels. However, this should not detract from efforts to lower the historical error rate. Performance audits have different goals than compliance audits: increasing use of performance audits should not mean reducing the emphasis on financial regularity and compliance.

- **Accountability.** ESIF control and audit procedures are part of an accountability chain involving MS and EU authorities which has seen not only a reduction in error rates, but also increased transparency on Cohesion policy's legality, regularity and achievements. The strength of this chain relies on the strength of its individual components at both EU and MS levels.

The research also provided some practical recommendations:

- **The designation procedure should be reconsidered**, targeting systems that are or have recently been in flux for full designation process but applying lighter approaches for established, stable systems;

- **More clarity should be provided on aspects that relate to the application of SCOs.** Procedures should be put in place to ensure that simplified controls on some aspects are not counterbalanced with additional controls on other elements of the same projects. A useful rule is contained in Article 14(i) of the ESF Regulation, which allows standard scales of unit costs and 'lump sums' to be set out in a delegated act.

- **Annual reporting should be further streamlined.** Simplification should include the timely publication of Commission guidelines, so that IT systems can be planned to collect the right data from the start, and the elimination of duplications or overlaps between this task and the Annual Control report prepared by the Audit Authority.

- **Dedicated rules and support should be established for the control and audit arrangements of specific types of programmes and operations,** notably European Territorial Cooperation programmes and Financial Instruments. For FIs, options include: separating out FIs in dedicated priorities; setting minimum allocations for the funds to be established (e.g. EUR 200 million); standardising the structures of funds; providing targeted and clear-cut Commission guidance to enhance legal certainty. For ETC, special exemptions or differentiation of rules could simplify management and limit the risk of errors. Special consideration should be given to the application of State aid rules.

1. INTRODUCTION

1.1 Background of the study

This study assesses the **relationship between two components of European Structural and Investment Funds (ESIF) – control and audit systems, and simplification measures designed to reduce the complexity of ESIF implementation – and explores how this relationship conditions ESIF performance.**

Financial control and audit are essential functions of any public policy. Beyond ensuring the regularity and legality of operations, and the sound financial management of procedures, control and audit provides important insights on implementation for programme authorities, allowing them to improve programme management and delivery and redress mistakes (e.g. recovering funds from beneficiaries). Thus, control and audit functions not only to strengthen trust and accountability, but also enhance the performance of the funds. Control and audit activities must be timely, in the sense that they have to enable corrective action to be taken, make those accountable accept responsibility, obtain compensation, or take steps to prevent or at least minimise breaches. Undertaking these functions, however, entails administrative complexity as substantial time and resources are dedicated to tracking, justifying and checking spend.

Issues of complexity are particularly relevant in ESIF where funding is implemented under 'shared management' and where European Union (EU) and Member State (MS) level bodies participate in multiple controls. In 2014-20, substantial efforts are being made to simplify, streamline and harmonise rules to increase both the accessibility and the performance of ESIF. Nevertheless, tensions between administrative complexities and the need for control continue to have an impact on ESIF performance. As the debate on the future of ESIF post-2020 intensifies, a key question is the degree to which a balance between the requirements for financial control and the need to limit complexity can be achieved.
Thus, the study provides an analysis of the control and audit systems used in ESIF, assessing efforts to reconcile the need for control and audit with the pursuit of simplification and enhanced performance.

1.2 Objectives

The research assessed the relationship between two components of ESIF – control and audit systems, and simplification measures designed to reduce the complexity of ESIF implementation – and explored how this relationship conditions ESIF performance.

Within this, the research included four specific aims:

- To provide an overview of the control and audit systems within ESIF, including the role of authorities and bodies involved.
- To produce a critical analysis of the control and audit provisions of the 2014-20 programming period in terms of their contribution to simplification.
- To analyse the role of the European Court of Auditors (ECA), including specificities of their audit approach (e.g. sampling methods, debate about error rate, different types of audit reports, etc.).

- To develop insights for the development of control and audit arrangements that enhance the pursuit of simplification and improved ESIF performance in the post 2020 period.

An analytical framework was developed to achieve these aims. This had four basic elements:

- **Disaggregation of different responsibilities** across the EU and MS levels in order to identify where in control and audit systems the most complex tasks lie.

- **Definition of complexity** in order to assess the nature and extent of the complexity associated with these different tasks. The definition includes costs incurred by the authorities charged with the management of the funds to undertake the tasks of financial control and audit (the work of administrative staff or outsourced tasks) and the administrative burden incurred by beneficiaries to comply with programme financial management and audit requirements.

- **Mapping simplification measures onto the complexities of control and audit**. A key part of the analytical framework is the mapping of different simplification measures and initiatives onto ESIF control and audit systems and procedures.

- **Determining the impact on ESIF performance.** Lastly, it was necessary to differentiate between various understandings of the 'performance' of ESIF. This is important as different audit and control provisions and simplification measures can influence different dimensions of performance: legality and regularity; financial absorption; timeliness of administrative activities; and, programme effectiveness.

Key research questions are grouped under four headings:

Based on the overall and specific objectives of the research and the issues highlighted in the analytical framework, the key research questions were identified as follows:

- **Where does the complexity of ESIF control and audit lie?** Which tasks create most complexity? Who bears this complexity? What impact do EU control and audit approaches have on this? What is the 'tipping point' beyond which adding more effort towards control and audits does not deliver returns? What reforms or measures can MS authorities introduce to ease complexity?
- **What is the impact of the EU's simplification initiatives** in addressing complexity in audit and control? Which are or are not working and why?
- **What impact are control and audit provisions having on the performance of operational programmes (OPs)?** Are simplification measures in the area of audit and control having an impact on different measures of performance (e.g. legality and regularity, financial performance, progress toward OP targets?)
- **Engaging in the post-2020 debate.** How can control and audit arrangements enhance the pursuit of simplification and improve ESIF performance in the post 2020 period?

1.3 Methodology

The research included five key tasks: providing an overview of the control and audit systems within ESIF; producing a critical analysis of the control and audit provisions of the 2014-20 programming period in terms of their contribution to simplification; carrying out specific analysis of the role of the ECA; developing insights for the development of control and audit arrangements that enhance the pursuit of simplification and improved ESIF performance in the post 2020 period; and providing conclusions and recommendations. These involved a combination of desk-based research and interviews at EU and MS levels, detailed below.

1) **Overview of the control and audit systems within ESIF**. Addressing ESIF but focusing on the European Regional Development Fund (ERDF), the European Social Fund (ESF) and the Cohesion Fund (CF), Task 1 was to provide an overview of the structures and processes involved in ESIF control and audit systems. This was based on documentary analysis of secondary data sources and legislation. Consulted documents included legislative documents (regulations, implementing and delegated acts) and official guidance documents relating to audit and control.

2) **Critical analysis of control and audit provisions**. Task 2 was to produce a critical analysis of the control and audit provisions of the 2014-20 programming period in terms of their contribution to simplification. This Task comprised:

    - **Assessment of related literature**. This included EU-level interviews at DG Regional and Urban Policy and DG Employment Directorates for Audit, the DG Regio Unit for Operational Efficiency, and the DG Regio Unit for Coordination, Relations with ECA and OLAF (the European Anti-Fraud Office). Interviews were also carried out with ECA representatives.

    - **Case study research**. Case studies of efforts to reconcile the requirements of sound financial control and audit and simplification in individual OPs provided a central component of the methodology. In addition to documentary research, case studies included interviews with the key organisations and actors involved: MAs and AAs. Seven programme case studies were selected based on: the implementation system, programme type and funding type and geographical area (see Table 1).

Table 1: List of case studies

Countries covered	OP	Objective	OP type	Geographical area	EU funding sources
Germany	Bavaria Employment OP	More developed	Regional	Central Europe	ESF
Denmark	Innovation and Sustainable Growth in Business OP	More developed	National	Northern Europe	ERDF
Romania	Regional OP	Less developed	Integrated regional	Eastern Europe	ERDF
Belgium	Flanders	More developed	Regional	Central Europe	ERDF
Portugal	Human Capital OP	Mixed	National	Southern Europe	ESF
Poland	Infrastructure and Environment OP	Less developed	National	Eastern Europe	ERDF & Cohesion Fund
Croatia, Italy, Greece, Slovenia (and 4 non MS)	Adriatic Ionian OP	Mixed	Territorial cooperation / transnational	Southern Europe and Balkans	ERDF

3) **Analysis of the role of the European Court of Auditors**. Including how specific aspects of its audit approach contribute to the reconciliation of control and simplification requirements. This Task included interviews with representatives of the Court.

4) **Insights for the post-2020 period**. Focusing on the ongoing debate on ESIF reform for the post-2020 period and based on desk research and interviews at EU and MS levels.

5) **Synthesis, conclusions and recommendations**. Synthesising the results of the previous Tasks, including practical insights on how the need for control and audit can be reconciled with the pursuit of simplification and enhanced ESIF performance and a focus on the lessons learned and the outlook for ESIF post-2020.

1.4 Structure of the study

The study is structured in five further sections:

- **Section 2** sets out the study's research context. This includes analysis of the role and importance of ESIF audit and control, experiences in 2007-13 (identifying benefits, costs), and introducing key challenges faced in finding a balance between systems which are rigorous enough to detect irregularities yet not too complex for beneficiaries.

- **Section 3** comprises a description of ESIF financial control and audit systems and tasks in 2014-2020, and an assessment of the causes and locations of complexity in these systems.

- **Section 4** explores how complexity arising from control and audit is addressed in the simplification agenda. This includes a review of key simplification measures introduced for ESIF in 2014-20 and an assessment of the experiences of programme authorities concerning these initiatives thus far in the period.

- **Section 5** turns to the treatment of control and simplification in the post-2020 debate. It includes a summary of the proposals tabled by the HLG on simplification and the review of opinions of the interviewees consulted for the study on the utility of the various measures being discussed.

- **Section 6** draws together the key lessons learned from the study, developing a set of main conclusions and recommendations for EU-level institutions and programme authorities.

2. RESEARCH CONTEXT

SUMMARY OF KEY FINDINGS

- The ESI Funds are implemented under a shared management system between the Commission and Member States. A wide range of regulatory requirements is codified in EU legislation to govern the use of EU Funds in the Member States. These rules are seen as complex and administratively burdensome, prompting regular calls for simplification.
- Over the past decade, there has been increasing emphasis on the financial control and audit of ESI Funds accompanied by increasing regulations and guidance in this field. As a result, the rules that aim to ensure compliance with the principles of regularity, legality and sound financial management have become a key focus of calls for simplification.
- For the 2007-13 period, it is not yet possible to provide a final assessment of audit and control activities and results, since the deadline for submission of closure packages to the Commission by the MSs was 31 March 2017 and closure documentation is still being appraised. However, recent ECA analysis of audit and control in 2007-13 has found that the Commission used the measures at its disposal to protect the EU budget more extensively and effectively than in the past.
- The evidence suggests that growth in audit and control is having a significant positive impact on the level of regularity, as the evolution of Cohesion policy control and audit systems over the past two decades has reduced error rates.
- On the other hand, despite regulatory reforms and significant effort on the part of the Commission and Member State authorities, growth in audit and control activities has been accompanied by significant challenges, including increased cost and burden and a negative effect on programme performance.
- Finding the right balance between systems that are rigorous enough to detect irregularities yet not too demanding or complex for administrations and beneficiaries is a difficult task.
- Building on earlier simplification efforts, the Common Provisions Regulation (CPR) for 2014-20 introduced a number of measures intended to simplify procedures and reduce the administrative burden associated with programme management and delivery. However, the initial experiences of the implementation of these measures have highlighted the need for further fine-tuning and programme authorities have queried whether there has been genuine simplification overall.
- A series of initiatives have been designed by the European Commission to improve ESIF performance by breaking the 'vicious cycle' of complexity, balancing requirements for sound financial control with the need for simplification. They include the High-Level Group on Simplification, the Omnibus Regulation (set to come into force in 2018), and the Better Regulation Agenda.

2.1 The role and importance of ESIF audit and control

ESIF is implemented under a shared management system between the Commission and Member States. In practice, the lead responsibility for all aspects of programme design and delivery lies with Member State authorities through a highly devolved, multi-level governance model. At the same time, a wide range of regulatory requirements is codified in

EU legislation to govern the use of EU funds in the Member States. These **rules are seen as complex and administratively burdensome, prompting regular calls for simplification** from both EU and national actors and stakeholders.

Prominent in this debate are rules that aim to ensure compliance with the principles of regularity, legality and sound financial management.[1] **Over the past decade, there has been increasing emphasis on the financial control and audit of ESI Funds.** This has been driven by:

- **Concerns among policy-makers about the efficiency and accountability of Cohesion policy under the shared management system**. Under this system, the design and operation of sound financial management systems is the responsibility of authorities at both EU and Member State levels.

- **High error rates and high political salience**. ESIF accounts for a substantial proportion of the EU budget (around 40% in 2014-20). The regional policy component (European Regional Development Fund - ERDF, European Social Fund - ESF and Cohesion Fund - CF), which is the focus of this study, accounts for just under one-third of the EU budget. High error rates for Cohesion policy, above the upper threshold (a 5% level of materiality[2]) adopted by the ECA for its transaction testing methodology, were perennially reported in its Annual Reports[3] with Commission explanations pointing to the inevitable complexity resulting from the involvement of a number of bodies at different levels and the high number of beneficiaries and co-financed operations linked to the overall volume of funds.[4]

- **The financial and non-financial benefits of audit and control**. Financial corrections under Cohesion policy resulting from controls and audits at any level excludes from EU funding expenditure that is not in accordance with applicable rules and regulations (e.g. ineligible expenditure or projects). When irregularities are detected, sums are recovered. However, ESIF audit and control also entails non-financial benefits in some MS, notably the introduction of mechanisms for the detection and rectification of irregularities and improvements in the implementation and performance of programmes. In the words of practitioners, financial management is "one of the most important links between efficient management within the Commission and effective governance reaching out into the Member States”.[5]

Against this background, there has been an **increasing focus on financial management, control and audit in ESIF over the past decade**. According to experts, Cohesion policy has witnessed an explosion in audit and control systems since the mid-2000s.[6] Reforms have included a package that comprised the creation of the Commission’s Internal Audit Service in 2001, as well as strengthening of financial control and audit functions in the Commission Directorates-General responsible for major components of the EU budget. It also led to the adoption in 2002 of a new Financial Regulation setting out broad principles and basic rules

[1] Bachtler J and Mendez C (2010) *Review and assessment of simplification measures in Cohesion policy 2007-2013*, note to the European Parliament's Committee on Regional Development.
[2] Errors are material if they exceed a certain level of error that is above what would be considered to be tolerable.
[3] Levy R, Barzelay M and Porras Gómez A-M (2011) ‘The reform of financial management in the European Commission: a public management policy cycle case study’, *Public Administration*, 89 (4). pp. 1546-1567.
[4] ECA (2008), ‘Annual Report for Financial Year 2007’, Luxembourg, *Official Journal C 286*, 10/11/2008, p145.
[5] Mendez C and Bachtler J. (2011) ‘Administrative reform and unintended consequences: an assessment of the EU Cohesion policy ‘audit explosion’, *Journal of European Public Policy*, 18 (5).
[6] Ibid.

relating to the EU budget. In 2008, the Commission published an Action Plan aimed at improving its supervision of Member States' management, control and audit systems.

2.2 Control and audit experience in 2007-13: benefits, costs

For the 2007-13 period, it is not yet possible to provide a final assessment of audit and control activities and results, since the deadline for submission of closure packages to the Commission from MS was 31 March 2017 and documentation is still being appraised. However, the ECA has analysed the way in which the Commission has made use of the regulatory provisions that were available during this period to protect the EU budget from irregular spending, and where possible and appropriate, included a comparison with the 2000-06 period.[7]

ECA analysis of audit and control in 2007-13 has found that:

- **The Commission used the measures at its disposal to protect the EU budget more extensively than in the past**. Financial corrections of around EUR 3 326 million had been imposed by the end of 2015. This corresponds to 1.0 % of the total budget envelope. In addition, payments for around EUR 28 446 million had been interrupted (8% of the total allocated envelope).

- **Preventive measures (suspensions and interruptions of payments when potential deficiencies are revealed by control and audit) were applied earlier and more extensively in 2007-13**. This allowed for more timely improvements to a larger number of management and control systems.

- **There was a relative increase in financial corrections imposed[8]** during the 2007-2013 period when compared to the level of irregular spending detected, indicating that the Commission had used the measures at its disposal to protect the EU budget more extensively.

- **The evolution of Cohesion policy control and audit systems has improved control and audit frameworks, with a significant, positive impact on error rates.** Changes introduced over the past 10-15 years, and especially the regulatory reforms introduced in 2007-13 (including the establishment of AAs) have improved control and audit frameworks and are having a significant, positive impact on error rates.[9] This is particularly visible when comparing error rates for the expenditure incurred in 2000-06 and 2007-13: for expenditure incurred in 2000-06 in 2007 and 2008 at least 11% was affected by error, whereas for the expenditure incurred until 2009 in the period 2007-13, the error rate estimated by the ECA was of at least 3%.[10] The positive trend seems to continue. The Commission's and the Court's estimated levels of error for the last three years of payments under the 'Cohesion' heading

[7] ECA (2017) *Special Report Protecting the EU budget from irregular spending: The Commission made increasing use of preventive measures and financial corrections in Cohesion during the 2007-2013 period*.

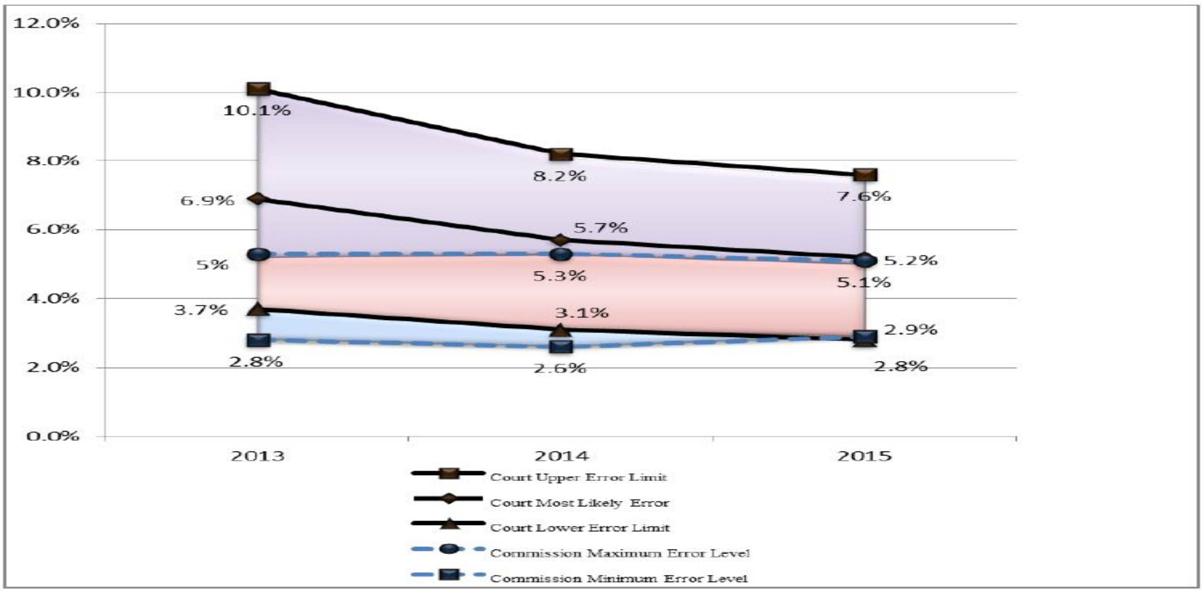
[8] Financial corrections can be implemented by through deducting irregular expenditure from the Member State's payment claim, by the payment of a recovery order issued by the Commission, or by decommitment. The deduction can take two forms: withdrawal or recovery from beneficiaries.

[9] Karakatsanis G and Weber M (2016) 'The European Court of Auditors and Cohesion policy', in Piattoni S and Polverari L (eds) *Handbook on Cohesion policy in the EU*, pp. 170-185, Edward Elgar: Cheltenham.

[10] Ibidem, p. 172.

(covering DGs REGIO and EMPL) show a falling most likely error rate from 6.9% to 5.2% of funding (see Figure 1).

Figure 1: Commission, ECA estimated levels of error, 'Cohesion' 2013- 2015



Source: European Commission (2017) *Root causes of errors and actions taken (Article 32(5) of the Financial Regulation),* Brussels, 28.2.2017. Based on Court's Annual Reports and DGs REGIO and EMPL Annual Reports for the financial years 2013 to 2015.

On the other hand, despite regulatory reforms and significant efforts on the part of the Commission and Member State authorities, growth in audit and control activities has been accompanied by significant challenges:

- **Error declining but still high compared to other EU budget headings**. The error rate for ESIF has remained persistently above the materiality threshold (set at 2%).

- **Increased complexity**. There is continued awareness among programme authorities and beneficiaries of the 'perverse effects' of ESIF control and audit, in terms of increasing the complexity of implementation and reducing the efficiency and effectiveness of programmes. The ex post evaluation of 2007-13 delivery systems found inefficiencies stemming from the multiplication of controls, inconsistent interpretation of rules, a low up-take of simplification measures[11], contributing to high administrative cost and burden on beneficiaries.[12]

- **Increased administrative costs**. According to information presented by the Commission in 2011, the overall administrative cost for the implementation of OPs for the 2007–13 programming period is 3.2 % of the total budget. Based on this information, the 'cost of control', which relates to the verification, certification and

[11] Including the single audit approach, as single audit status by end of 2014 had been granted only to 76 out of 440 ERDF/Cohesion Fund and ESF OPs, Karakatsanis G and Weber M (2016) *Op. cit*., pp. 176-77.

[12] KPMG and Prognos (2016) *Ex post evaluation of Cohesion policy programmes 2007-2013, focusing on the European Regional Development Fund (ERDF) and the Cohesion Fund (CF)*. Final report to the Directorate-General for Regional and Urban Policy (European Commission), work package 12 – Delivery system, pp. 17-18.

audit activities carried out by national authorities, accounts for 0.9 % of the total budget (i.e. less than 30% of the total administrative cost). Around one fifth of the 'cost of control' is related to 'programme audit' (the work of national audit authorities).[13] Another study sheds further light on the cost of ESIF audits (ERDF and CF) to the national authorities.[14] The study estimated the total cost related to the administration of the Funds for the period 2007-13 to be EUR 12.5 billion. Audit costs for the same period are estimated at EUR 1.05 billion, representing 8.4% of the total cost. Increased levels of control have caused a significant administrative burden on national administrations and beneficiaries. This is particularly the case in Member States where administrative capacity or experience of ESIF implementation is limited, in programme contexts where funding covers a large number of smaller operations, or where specific types of programme (e.g. European Territorial Cooperation) or operation (e.g. Financial Instruments - FIs) create specific challenges for control and audit.[15]

- **Negative impact on ESIF performance.** There are a number of ways in which the complexity created by increased control and audit provisions have complicated implementation and hampered policy performance. Complexity acts as a disincentive for administrations to the financing of experimental and riskier projects; making administrations reluctant to support new types of beneficiaries, which lack a track record of successful project completion; leading programme authorities to focus administrative resources almost exclusively on the tasks of control and audit at detriment of strategic design and project generation and selection; and, discouraging potential beneficiaries from applying for support, especially where alternative sources of funding are available.[16] Dealing with the tasks of control and audit also limits the time available for Managing Authorities (MAs) and Implementing Bodies (IBs) to carry out more strategic monitoring of performance, as emerged in case study interviews. Programme authorities are aware of an increasing focus on results and performance but financial compliance still takes priority as non-compliance leads to financial corrections while failure to achieve results does not. Obligations in terms of management verifications and audits mean that there is less time to monitor the actual achievements of operations and programmes.

2.3 Control and simplification

Finding the right balance between systems that are rigorous enough to detect irregularities yet not too time-consuming or complex for administrations and beneficiaries is a difficult task. While European Parliament resolutions[17] and ECA reports[18]

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13 SWECO (2010), *Regional governance in the context of globalisation – reviewing governance mechanisms & administrative costs. Administrative workload and costs for Member State public authorities of the implementation of ERDF and Cohesion Fund*, DG Regional Policy (June 2010)

14 European Parliament (2012) *Op. cit*; t33 et al. (2012) *Measuring the impact of changing regulatory requirements to administrative cost and administrative burden of managing EU Structural Funds (ERDF and Cohesion Funds)*, Brussels: European Commission, Directorate-General for Regional Policy.

15 SWECO (2010) *Op. cit.*

16 Davies S and Polverari L (2011) 'Financial accountability and European Union Cohesion policy', *Regional Studies*, vol. 45, no. 5, pp. 695-706.

17 See, for instance, European Parliament resolution of 16 May 2017 on the Annual Report 2015 on the protection of the EU's financial interests – Fight against fraud.

18 ECA (2017) *Op. cit.*

emphasise the need for systems and procedures that reduce the level of irregularities and fraud, stakeholders and practitioners call for initiatives to simplify those systems.

A number of simplification measures were introduced to ESIF audit and control systems already during 2007-13 (and a few even during 2000-06). However, uptake was often limited. Notable initiatives included:

- **The 'single audit' principle.** The principle of proportionality and reduction of European Commission audit work following an unqualified audit opinion issued by the national Audit Authority and the 'single audit' principle (Art. 73 of Council Regulation (EC) No 1083/2006[19]). The 'single audit' principle, specified in Article 73 of Regulation (EC) No 1083/2006, referring to a system where each level of control builds on the preceding one is important in this regard. 'Single audit' aims at preventing the duplication of control work and reducing the overall cost of control and audit activities at the level of the MS and the Commission. It also aims at decreasing the administrative burden on those audited. "Article 73 status" meant that the Commission was satisfied that the national compliance assessment and the audit authority's audit strategy provided sufficient assurance that the management and control systems of the Operational Programme functioned effectively. This allowed the Commission to reduce its own audits and checks on the programme or Member State and to use its resources elsewhere to audit those programmes considered more at risk. Concerning uptake, as of December 2012, the Commission had granted Article 73 status to 61 of the 434 OPs in 12 of the 27 Member States: 51 ERDF OPs in 10 Member States and 10 ESF OPs in five Member States.[20] This pattern repeated the experience of 'contracts of confidence' in the 2000-2006 period. Contracts were bilateral administrative arrangements signed with national authorities by the Commission if it had reasonable assurance that the financial management and control systems for one or more funds complied with the requirements of Commission Regulation (EC) No 438/2001 and that the national authorities had drawn up a satisfactory audit strategy. The Member State also undertook to submit reports on its audit activities to the Commission. Where a contract of confidence was signed, the Commission agreed in principle that it would no longer carry out audits in the Member State (or region) concerned. Contracts of confidence were signed between 2005 and 2009 with Austria, Cyprus, Denmark, Estonia, Portugal, Lithuania, UK (England), UK (Wales) and Slovenia for 55 OPs.[21]

- **Simplified Cost Options (SCOs).** SCOs are options for programme authorities to calculate eligible expenditure of grants and repayable assistance on the basis of flat rate financing, standard scales of unit costs and lump sums. They were introduced to address concerns over administrative, burdens reduce error rates, enhance the access to the Structural Funds of small beneficiaries with limited capacities and, in the medium-term, allow for a refocussing of resources towards the achievement of policy objectives. In terms of uptake, in 2007-2013 7% of total ESF expenditure, or approximately EUR 8 billion, was declared under at least one type of SCO; 63 OPs used flat-rate financing, 65 OPs used unit costs, and 12 OPs used lump sums. Data

[19] Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999

[20] ECA (2013) 'Taking stock of 'single audit' and the Commission's reliance on the work of national audit authorities in Cohesion', *Special Report* No 16/2013.

[21] In line with the Communication on contracts of confidence (SEC(2004)632/2) adopted by the Commission on 18 May 2004.

for ERDF uptake of SCOs are currently being gathered but a representative of DG REGIO noted in 2017 that it has been limited.[22] A DG EMPL survey highlighted the legal uncertainty, fear of systemic error and poor alignment with national/regional legal systems as causes of limited uptake.[23]

Building on earlier simplification efforts, the CPR for 2014-20 introduced a number of further measures intended to simplify procedures and reduce the administrative burden associated with programme management and delivery.[24] Based on the shortcomings that emerged during the 2007-13 period, reforms introduced for the 2014-20 period introduced a number of innovations aimed at simplifying control and audit requirements.

Simplification was a major theme during the debate on the reform of Cohesion policy for the 2014-20 period and in the new regulations. As well as supporting the extended application of the 'single audit' principle and SCOs, further key changes involved:

- **More flexibility**. The option for multi-Fund programmes and monitoring committees; the option to merge the MA and CA; and, more varied options for FIs;
- **Improved clarity on tasks and responsibilities of different authorities**. Assignment to the MAs of the responsibility of carrying out proportionate and effective antifraud measures, based on risk assessment, and the possibility for programmes with financial allocations less than EUR 250 million to subsume the Audit Authority within the same authority that also acts as Managing Authority;
- **Increased proportionality.** This included: the use of risk-based methods of sampling for controls; the decision that smaller projects would be audited only once before closure; scope to reduce controls & audit intensity, including through the extended application of the 'single audit' principle;
- **Simplified designation of control and audit systems**. The aim to move to national designation instead of Commission approval of management and control systems (review by the Commission only in specific cases);
- **Legal certainty through clearer rules**, for instance through the use of flat rates for revenue-generating projects;
- **Simplified audit arrangements for Financial Instruments;**
- **Lighter reporting requirements** (e.g. for annual reports);
- **Reducing the administrative burden for beneficiaries** (e.g. through increased use of SCOs);

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[22] 'Simplification network singled out for its "great" work on SCOs': https://ec.europa.eu/esf/transnationality/content/simplification-network-singled-out-its-great-work-scos

[23] DG EMPL (2016) *Simplified Cost Options in the European Social Fund: promoting simplification and result-orientation,* Luxembourg: Publications Office of the European Union, 2016.

[24] For a review see Davies S (2015) 'Is simplification simply a fiction?' *IQ-Net Thematic Paper 37(2)*, European Policies Research Centre, University of Strathclyde, Glasgow; and EPRC (2016) 'The simplification of EU Cohesion policy: Problems and Priorities for Change', *IQ-Net Briefing,* January 2016, European Policies Research Centre, University of Strathclyde, Glasgow.

- **Easing audit burden at closure**. Including through mandatory annual closure of operations in the annual clearance of accounts;

- **E-Cohesion;** and,

- **Simplification of European Territorial Co-operation.**

However, the initial experiences of the implementation of these measures have highlighted the need for further fine-tuning.[25] Programme authorities have queried whether there has been genuine simplification if the whole package of regulations, acts and guidelines is taken into account, and argued that simplification has benefited beneficiaries but not OP authorities. According to some programme authorities, reforms introduced for 2014-20 also added new rules that generated more complexity, undermining gains resulting from simplification initiatives. For instance, programme authorities have experienced additional complexity from the introduction of ex-ante conditionalities and the Performance framework.[26] The aims of these measures are important: to strengthen the effectiveness of Cohesion policy implementation through strengthening policy, regulatory and institutional conditions and through closely monitoring progress against objectives and targets. Nevertheless, the efficacy and impact of these measures in achieving these goals remains open to question. It is important that analyses of these measures takes into account their 'fitness for purpose 'as well as the additional administrative burden that they generate. Programme authorities from across the EU continue to call for greater simplification of OP financial management and proportionality in audit and control.[27]

In the course of the 2014-20 period, the European Commission and the European Parliament have both restated the need to reconsider arrangements for simplifying control and audit.[28] This applies to the remainder of the period and the future, reviewing the operationalisation of shared management in order to avoid the delays that are characterising the current programming cycle, and render all procedures more manageable for the authorities in charge of the funds and programme beneficiaries.

- **A High Level Group on Simplification**, established by the Commission in July 2015,[29] has formulated a number of recommendations on simplification in a number of areas,[30] including control and audit (see Section 5).

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25 *Ibid*.

26 Bachtler J, Mendez C and Polverari L (2016) 'Ideas and Options for Cohesion policy Post 2020', *IQ-Net Thematic Paper 38(2)*, European Policies Research Centre, University of Strathclyde, Glasgow, and European Court of Auditors (2017) *Ex ante conditionalities and performance reserve in Cohesion: innovative but not yet effective instruments*, Special report N°15/2017.

27 Lehuraux T (2017) 'Gathering implementation speed: the progress of Structural Funds programmes', *IQ-Net Review Paper* 40(1), European Policies Research Centre, University of Strathclyde, Glasgow.

28 European Commission (2016a) *Strategic Plan 2016-2020,* DG Regional and Urban Policy, May 2016, Brussels; European Parliament (2017a) Resolution of 16 February 2017 on investing in jobs and growth – maximising the contribution of European Structural and Investment Funds: an evaluation of the report under Article 16(3) of the CPR (P8_TA -PROV(2017)0053); European Parliament (2017b) Resolution of 16 February 2017 on delayed implementation of ESI Funds operational programmes – impact on Cohesion policy and the way forward (P8_TA-PROV(2017)0055); European Parliament (2016a) Resolution of 11 May 2016 on acceleration of implementation of Cohesion policy (P8_TA(2016)0217); European Parliament (2016b), Resolution of 6 July 2016 on synergies for innovation: the European Structural and Investment Funds, Horizon 2020 and other European innovation funds and EU programmes (P8_TA(2016)0311); and European Parliament (2015) Resolution of 26 November 2015 'Towards simplification and performance orientation in Cohesion policy 2014-2020' (P8_TA(2015)0419).

29 'High Level Group of Independent Experts on Monitoring Simplification for Beneficiaries of the European Structural and Investment Funds'.

30 These include e-governance, simplified cost options, easier access to EU funding for SMEs, financial instruments, gold-plating, and control and audit.

- **The Better Regulation Agenda**. Cutting across these issues is the Commission's 'Better Regulation Agenda', a package of reforms adopted in 2015 to boost transparency in the EU decision-making process, improve the quality of new laws through better impact assessments of draft legislation, and promote constant and consistent review of existing EU laws, so that EU policies achieve their objectives in the most effective and efficient way. As part of this, the REFIT Platform brings together the Commission, national authorities and other stakeholders in regular meetings to improve existing EU legislation. The aim is to keep the entire stock of EU legislation under review and ensure that regulatory burdens are minimised and that all simplification options are identified and applied.[31]

- **Omnibus Regulation**. At the end of 2016, the Commission, in the framework of the mid-term review/revision of the multiannual financial framework (MFF) 2014-20, proposed a new Omnibus regulation, amending several regulations on the implementation of EU policies in 2014-20 (including the CPR applicable to Cohesion policy) and the financial rules applicable to the general budget, with the stated goal of pursuing further simplification and flexibility for remainder of the programming period (2017-20).[32] In this new proposal, the Commission restated that sound financial management remains a key objective of EU financial rules and that the new regulation strengthens the systems in place to protect the EU budget against fraud and financial irregularities, and contributes to reduce the administrative burden of programme implementation and the number of errors, in so doing also supporting a higher impact of EU policies on the ground.[33]

The Omnibus regulation proposal is anticipated to enter into force in 2018. The draft Omnibus regulation highlights basic aims and principles designed to strengthen simplification in the rest of the 2014-2020 period (Table 2):

Table 2: ESIF simplification and financial control 2014-20 – current measures and proposed changes

Aim	Measure
From multiple layers of controls to cross reliance on audit, assessment or authorisation, and harmonisation of reporting requirements	Increased reliance on one single audit, assessment or authorisation (e.g. conformity to State aids rules), when conditions are met to be taken into account in the EU system Increased reliance on implementing partners' own procedures once these have been positively assessed (i.e. European Investment bank - EIB, International Monetary Fund, promotional banks, NGOs etc.) Signature of financial framework partnership agreements with long term partners to improve harmonisation of audit, reporting and other

[31] European Commission (2015) *Commission Staff Working Document – Better Regulation Guidelines*. Document SWD(2015) 111 final.

[32] European Commission (2016b) *Proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union*, Brussels, 14.9.2016, COM(2016) 605 final, 2016/0282 (COD).

[33] European Commission (2016a) *Op. cit.*, p. 3.

Aim	Measure
	administrative requirements (Omnibus Title V Articles 122, 123 and 126)
More effective use of financial instruments:	Including through ensuring a level playing field among key EU implementing partners and reducing burdensome requirements related to publication of individual data of final recipients or to the exclusion criteria.
Simplified accounting	Increased use of simplified cost options, lump sums, prizes, payment based on output and results (Article 121, Omnibus Title XIII)
Harmonised rules across funds	Application of only one set of rules when combining different funding sources (e.g. ESIF, EFSI and financial instruments (Omnibus Title V)
Focus on results and streamlining of reporting: the proposal includes a series of measures aimed at.	focusing better the budget on results, establishing a clear performance framework, enhancing transparency and streamlining reporting
Simplified rules for beneficiaries in relation to grants	For example, removal of non-cumulative award check for low-value grants and of the non-profit principle; simpler rules for 'contribution in kind' valuation; grant awards without calls for proposal under specific conditions, simplified forms of grants (Omnibus Title VIII)
Simpler and leaner EU administration: the proposal provides for	A series of simplification proposals aiming to allow EU institutions to work more efficiently, notably by implementing jointly administrative appropriations to achieve economies of scale.

Source: Commission proposal on the "Omnibus regulation".[34]

At the time of writing, the content of the Omnibus is still being finalised. However, it is possible to highlight some concrete proposals that indicate the broader direction of travel:

- The pursuit of **simplification measures for specific types of operation**. This includes regulatory provisions for financial instruments: no 'on the spot' verifications for the European Investment Bank or other international financial institutions; extended power for the Commission to set the model for the reporting of FIs in control and audit reports; and allowing an irregularity to be replaced by regular expenditure within the same FI operation to avoid net loss. Reduce the administrative burden for

[34] European Commission (2016b) *Proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union and amending Regulation (EC) No 2012/2002, Regulations (EU) No 1296/2013, (EU) 1301/2013, (EU) No 1303/2013, EU No 1304/2013, (EU) No 1305/2013, (EU) No 1306/2013, (EU) No 1307/2013, (EU) No 1308/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014,(EU) No 283/2014, (EU) No 652/2014 of the European Parliament and of the Council and Decision No 541/2014/EU of the European Parliament and of the Council*, Brussels, 14.9.2016, COM(2016) 605 final, 2016/0282 (COD).

revenue generating operations by raising the threshold exempting operations from calculating and taking account of revenue generation during implementation.

- **Extending the use of Simplified Cost Options.** This includes promoting of the use of lump sums by removing the upper limit of EUR 100 000 of public contribution; reducing the administrative burden associated with the use of SCOs by basing on conditions other than costs. (e.g. fulfilment of conditions related to implementation or the achievement of programme objectives); the obligatory use of standard scales of unit costs, lump sums or flat rates for operations below a certain threshold for ERDF and ESF.; and increased use of flat rates that do not require MS to establish a methodology.

- **Strengthening the 'Single Audit' principle.** The 'Single Audit' principle should be reinforced and the thresholds below which operations are not subject to more than one audit should be doubled.35

Thus, it is possible to identify **a series of initiatives that have been designed to improve ESIF performance by breaking the 'vicious cycle' of complexity, balancing requirements for sound financial control with the need for simplification**. In order to assess these initiatives, Section 3 sets out in more detail the ESIF system for financial control and audit and identifies where most complexity arises.

[35] Under Article 148 of the CPR, operations for which the total eligible expenditure does not exceed EUR 200 000 for the ERDF and the Cohesion Fund, EUR 150 000 for the ESF or EUR 100 000 for the EMFF should not be subject to more than one audit by either the audit authority or the Commission prior to the submission of the accounts for the accounting year in which the operation is completed.

3. IDENTIFYING COMPLEXITY

SUMMARY OF KEY FINDINGS

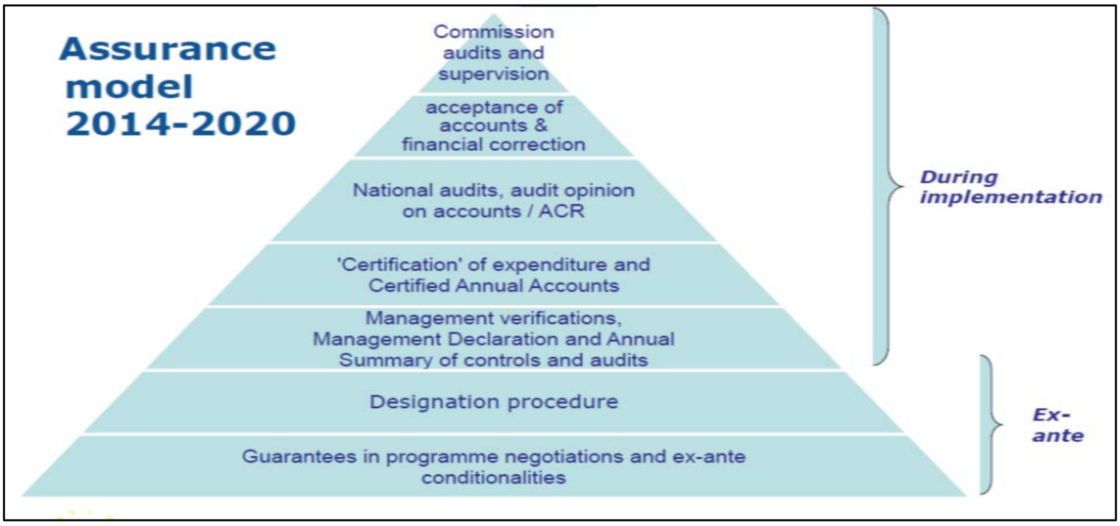
- The ESIF 'shared management' model involves a number of EU and Member State level bodies in multiple controls. The European Court of Auditors, as the EU's external, independent auditor, plays a particularly crucial part in ensuring sound financial management, accountability and transparency. It is currently trialling a new approach to the auditing of the EU Budget, focusing on the results of audits carried out by the Commission and MS audit institutions, and on net (residual) error rates. This new approach is being piloted on Cohesion policy for the expenditure of the financial year 2017 and results will be reported in the Court's Annual Report 2018. It is intended to streamline the overall auditing process and reduce duplications.
- Coordination challenges between different audit institutions are being addressed also with methodological harmonisation and administrative arrangements, while an increased use of performance audits and tolerable error rates are also being discussed.
- Assessing the complexity of ESIF control and audit systems requires the disaggregation of different responsibilities across the EU and MS levels.
- The two tasks perceived by MAs to be the most complex are the designation process and the annual summaries.
- Designation is taking a very long time across all EU Member States, which in turn is leading to delays in financial implementation because only advance payments can be made until designation is complete. In theory, the designation process should not create excessive complexity, as provisions for proportionality were included. However, Member States have preferred a 'heavy' procedure to guarantee assurance and limit the scope for retroactive audit measures. The designation procedure has been more time-consuming and complicated than in 2007-13.
- Administrative verifications also create considerable burden and complexity and could be made more proportionate. MAs have also struggled to comply with their new anti-fraud responsibilities, which have been cumbersome to deliver and required training and resources.
- AAs identify most complexity with the production of annual reports under Article 59(5)(b) of the Financial Regulation. Systems audit also requires significant capacity, especially in large or complicated programmes (including ETC programmes).
- Statistically representative sampling creates more assurance but makes audit work more complicated. Some AAs acknowledge that the Commission has provided guidance on approaches to developing samples, but find the various methodologies complex.
- The requirement for annual audit reports lessens complexity at the end of programme periods but creates time pressures. Some AAs saw the reduction in the time allocated for sending the control report and audit opinion to the Commission, from one year to around 6-8 months, as the most complex problem they are facing.
- The degree of complexity generated by audit requirements varies in terms of what is being audited. Certain types of programmes (ETC) or operations (e.g. revenue-generating projects, FIs) are more complicated.

- Complexity also varies in function of domestic institutional choices. Administrative stability tends to constrain complexity: the risk of error and complexity in financial control and audit increases where institutional arrangements are in flux or staff turnover is high.
- At EU level, lack of a standardised approach to the regulations governing EU instruments under shared management (ESIF) and direct management (e.g. COSME, Horizon 2020) constrains the pursuit of synergies and creates complexity.
- A common cause of complexity noted by programme authorities is the provision of EU guidance in untimely and fragmented manner, which leads to lack of legal certainty and ambiguity.
- Coordination and consistency in audits is crucial in limiting complexity, given the different levels of control to which ESIF programmes and operations are subject. The role of the European Commission and ECA is important in this. A number of current initiatives are aiming to increase the cooperation between the Commission and the ECA in developing consistent methodological approaches and in drawing on each other's results.

3.1 What does ESIF financial control and audit involve?

The ESIF 'shared management' model involves EU and Member State level bodies in multiple controls (see Figure 2). This process is designed to strengthen the assurance that ESIF transactions are legal and regular and to reinforce the accountability of MS in the audit process throughout the programming period (e.g. through the description and assessment of management and control systems at the outset of the period, various levels of controls at national and programme levels during implementation and a final control report in the closure package).

Figure 2:ESIF assurance model 2014-2020



Source: Byrne, D. (2014) 'Management and control systems' presentation organised by EIPA-Ecorys-PwC, Brussels, September 2014.

Thus **ESIF financial control and audit occurs at different levels:**

At MS level: In 2014-20, MS have been required to provide ex-ante assurance on the set-up and design of the management & control system, confirming that programme authorities are in a position to fulfil their responsibilities, building on audit and control work carried out under the previous period. This requires designation of a Managing Authority (MA), a Certifying Authority (CA) and an Audit Authority for each Operational Programme (OP), describing the relative responsibilities and functions in dedicated documents, outlining the management and control systems in place for the programme.[36]

- **Managing Authorities** carry out first-level checks of operations (management verifications) and the expenditure declared before the expenditure is certified by the Certifying Authority, where present, as legal and regular.

- **Certifying Authorities**, where present, are generally placed within national Ministries of Finances, or within internal control bodies of sectoral ministries or regional authorities. They are responsible for making declarations to the Commission and verifying the accuracy of programme accounts.

- **Audit Authorities** provide assurance to the Commission regarding the effective functioning of the management systems and internal controls for an OP (and, as a consequence, the legality and regularity of the expenditure certified). They must be functionally independent from the bodies managing the funds. In most cases the audit authorities are separate departments within State chancelleries, Ministries of Finance (or internal control bodies under ministry authority), other ministries or Supreme Audit Institutions.

At EU level, Commission bodies carry out control and audit activities, including system audits and audits of samples of operations. DG Regional Policy and DG Employment have units focused exclusively on audit and country desks are also involved in issues relating to financial management, control and audit.

As the EU's external auditor, the **ECA plays a crucial part in ensuring sound financial management, accountability and transparency**. For ESIF, audit by the ECA involves: checking individual transactions (the annual report on the implementation of the EU budget); assessing the operations of EU institutions (annual reports on the institutions and agencies); and, reviewing the effectiveness of policy initiatives (special reports). Within this, the Court realises three distinct but complementary types of audits:[37]

- **Financial Audit.** ECA Annual reports verify whether financial information presented by the responsible authorities is in accordance with the applicable financial reporting framework and whether incorrectly calculated costs were claimed in respect of projects co-financed by the EU. This is accomplished by obtaining sufficient and appropriate audit evidence to enable the auditor to express an opinion as to whether the financial information is free from material misstatement or miscalculation.
- **Compliance Audit**. The ECA Annual Report on revenue and expenditure of Cohesion policy contains a 'statement of assurance', certifying the reliability of the accounts and the legality and regularity of the underlying transactions. This includes an estimation of the most likely error rate in reporting of financial transactions, based on a statistically representative sample of ESIF transactions relating to both revenue and

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[36] Although MS can opt to subsume CA functions under the Managing Authority and/or designated Implementing Bodies (Art. 106 CPR).

[37] Karakatsanis G and Weber M (2016) *Op. cit.* See also INTOSAI (no date) *ISSAI 100. Fundamental Principles of Public-Sector Auditing,* available at http://www.issai.org/en_us/site-issai/issai-framework/3-fundamental-auditing-priciples.htm.

expenditure, down to beneficiary level. The second main source of audit evidence is the verification of the effectiveness of the internal control systems applied by the EU institutions and MS.

- **Performance Audit**. Over the past two decades, the Court has gradually incorporated audit work that focuses on the results and impact of Cohesion policy, establishing and further developing its performance audit practice. Performance audits are summarised in special reports and in separate sections of the annual report. Special reports can cover compliance and performance audits. Those covering performance audit can deal with specific aspects of ESIF implementation - such as closure, the negotiations of Partnership Agreements and Operational Programmes, the ex ante conditionalities and performance reserve[38] or specific themes, such as airport infrastructure or youth unemployment.[39]

The Court also prepares **opinions** on legislative proposals, either on its own initiative or at the request of the Commission, the European Parliament and the Council.

Thus, ESIF's 'shared management' model creates a complex system of multiple checks where EU, MS and programme-level bodies participate in a range of internal and external controls (see Figure 3 for a visual description of the OPs' management and control systems).

- **Internal controls** are realised by the authorities responsible for correct management and disbursement of the funds (Managing Authorities, Implementing Bodies (IB), Certifying Authorities). These activities include:
    - management verifications by MAs
    - certification of expenditure by the Certifying Authorities (which, where appointed, are responsible for certifying the completeness, accuracy and veracity of payment declarations, that the expenditure complies with applicable EU and national rules, and assert that the expenditure declared has been duly verified by the MAs).

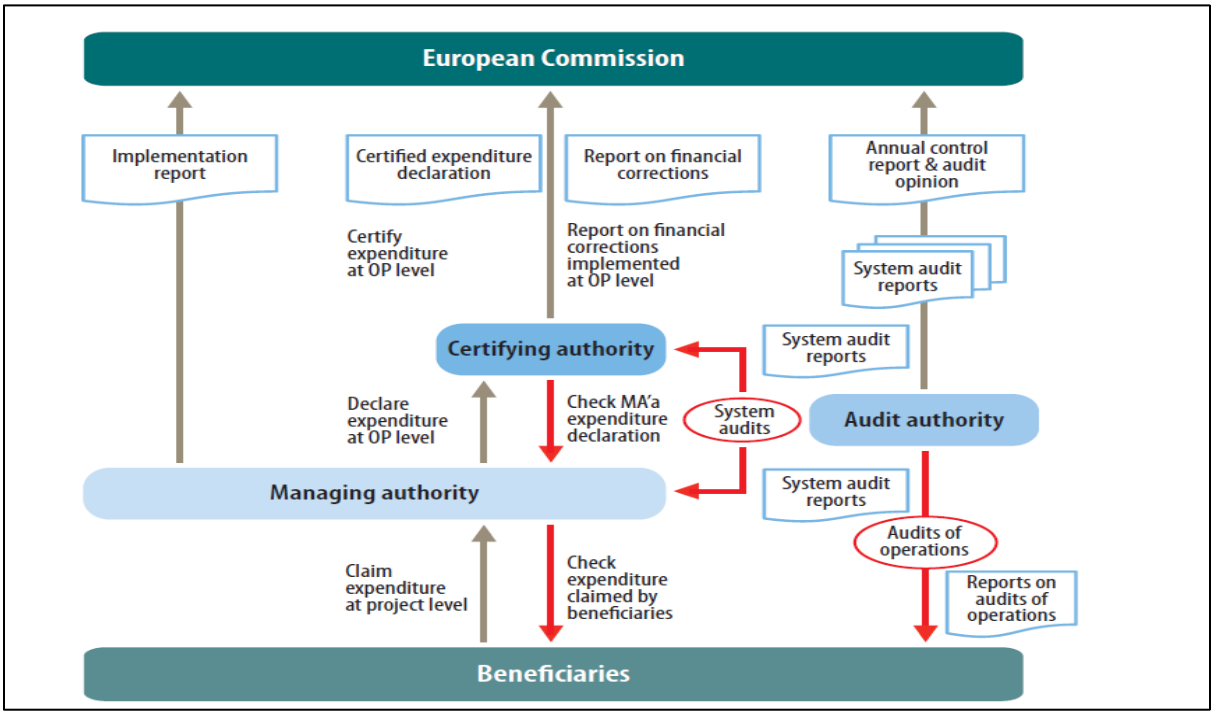
- **Internal audits** comprise:
    - the systems audit realised by the Audit Authority for each programme
    - the financial and compliance audits carried out by programmes' Audit Authorities. These are functionally independent from the authorities managing the funds and, in addition to systems audits, also realise audits on a sample of operations and selected functions of the management system, and
    - the audits carried out by the Commission (Art. 68 CPR).

[38] European Court of Auditors (2016) *An assessment of the arrangements for closure of the 2007-2013 cohesion and rural development programmes,* Special report N°36/2016; European Court of Auditors (2017) *The Commission's negotiation of 2014-2020 Partnership Agreements and programmes in Cohesion*, Special report N°2/2017; European Court of Auditors (2017) *Ex ante conditionalities and performance reserve in Cohesion: innovative but not yet effective instruments*, Special report N°15/2017.

[39] European Court of Auditors (2017) *Youth unemployment – have EU policies made a difference? An assessment of the Youth Guarantee and the Youth Employment Initiative*, Special Report N°5/2017; European Court of Auditors (2014) *EU-funded airport infrastructures: poor value for money,* Special Report N°21/2014.

- **External audits** are the audits carried out by Supreme audit institutions, i.e. national/sub-national Courts and the ECA, i.e. by external audit bodies, which are not part of the executive branch of government.[40]

Figure 3: Management and control system for OPs



Source: European Court of Auditors (2013) *Taking stock of 'single audit' and the Commission's reliance on the work of national audit authorities in cohesion*, Special Report No. 16, 2013.

Within this, the role of the ECA requires specific attention. Over successive programming periods, the dynamic of Cohesion policy has been driven by the need to improve legality and regularity and the Court is part of multiple layers of audit in an effort to reduce the error rate. As the EU's external auditor, the ECA's key remit is to 'provide impartial information to the EU's legislative authorities (that is, the European Parliament and the Council) and to the wider public on how the EU budget is spent. Based on its mandate, it examines the EU's financial management and assesses whether EU policies and programmes achieve their intended objectives (European Union 2012: Art. 287)'.[41]

As part of its annual reports on the implementation of the European Budget, the ECA publishes a specific assessment on Cohesion policy (as it does also for other main policy areas funded by the EU budget). Each year, for each specific assessment of Cohesion policy, the ECA examines a sample of between 150-180 transactions, including 'on-the-spot' inspections of selected projects. The Court's testing includes the entire project cycle and covers compliance with the applicable EU and national rules (including state aid and public procurement).[42] In addition, the ECA examines the reliability of annual control reports submitted by AAs to the Commission (sometimes re-running a sample of audits to check the accuracy and reliability of the AAs' work). Moreover, every year, the Court 'reviews the Commission's annual activity reports and assesses the Commission's supervision of the

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[40] Karakatsanis G and Weber M (2016) *Op. cit.*

[41] Ibid, p. 171.

[42] Weber M and Gantzer-Houzel S (2014) 'Risk of Non-compliance with State Aid Rules in Cohesion policy Lessons Learnt from the 2007-2013 Period', *European Structural and Investment Funds Journal*, Volume 2 (2014), Issue 2.

national audit authorities'.[43] These seemingly numerous checks are a result of the independence of different levels of audit, set out in the Treaty on the Functioning of the EU: the ECA and national audit bodies must cooperate in a spirit of trust while maintaining their independence (TFEU Article 248 (3)). It should be noted, however, that that the number of ECA (and also of Commission) Cohesion policy audits is very small compared to the number of audits carried out by MS authorities. For instance, in the period 2010-2014, the ECA audited 1 573 ERDF, CP and ESF operations:[44] in 2015 alone, MS authorities audited a total of 12 270 operations.[45] It should also be noted that, starting with the expenditure of 2017, the Court is piloting a change in its approach to the auditing of the EU Budget, which entails a focus on the results of audits carried out by the Commission and MS audit institutions, and on net (residual) error rates (i.e. errors after the actions taken to address them). This new approach is being piloted on Cohesion policy in relation to the expenditure of the financial year 2017. In practice, the Court is testing 'the accuracy of the information provided by the European Commission on the legality and regularity of Cohesion spending' by examining 'the checks already carried out by the European Commission and by the audit authorities in Members States, through a review of audit files and the re-performance of audit work carried out at beneficiary level', in order to conclude whether the residual total error rates reported by the Commission, are reliable.[46] This is intended to streamline the overall auditing process and reduce duplications. Results of this pilot will be reported in the Court's Annual Report 2018 and, if successful, the approach will be continued and extended to other policy areas as well.

A related issue is the calculation of the materiality threshold of tolerable error for Cohesion policy. This concerns achieving consensus on an acceptable level of error (i.e. breaches of rules in using Cohesion policy funds, expressed as a percentage of the funds spent) and on the methodologies used to calculate these rates. Critics have questioned the value of substantial resources being used to deliver a single overall error rate per policy area.[47] Moreover, studies suggest that the cost of financial accountability mechanisms needs to be taken into account when designing systems because these costs can outweigh potential benefits in terms of increased efficiency or reduced corruption.[48] **In this context, it is important to note the aforementioned Court's performance audits.** Alongside compliance audits, performance audits have value in a number of respects: in informing the Court's role in making recommendations on how to improve the 'value for money', efficiency and effectiveness of ESIF, in identifying specific ESIF implementation issues or themes where simplification could be beneficial, and in incentivising programme authorities to focus on results away from a focus mainly on error rates. Thus, there is an argument that a stronger focus on performance auditing can produce better assessment of the efficiency and effectiveness of operations and contribute indirectly to proposals for simplification, by pointing to aspects of management that are not effective.[49] While the growing use of performance audits by the ECA' has been noted over the past two decades[50], there has been an increased focus on this type of audit in the last 5-10 years. Moreover, to avoid duplication

[43] Karakatsanis G and Weber M (2016) *Op. cit.,* p. 179.
[44] ECA (2016c) *More efforts needed to raise awareness of and enforce compliance with State aid rules in cohesion policy*, Special Report 24/2016.
[45] Sébert F (2016) 'Audit of ESF and ERDF ', presentation at *High Level Expert Group meeting* 29/11/2016.
[46] European Court of Auditors (2017) *Background paper: The ECA's modified approach to the Statement of Assurance audits in Cohesion*, 14.12.2017, p. 1.
[47] Stephenson P (2015) 'Reconciling audit and evaluation? The shift to performance and effectiveness at the European Court of Auditors'. *European Journal of Risk Regulation*, 6, 79-89.
[48] Mulgan R (2003) *Holding Power to Account: Accountability in Modern Democracies*, Palgrave MacMillan, New York.
[49] European Parliament (2015) *Towards simplification and performance orientation in Cohesion policy 2014-2020* (2015/2772(RSP) European Parliament resolution of 26 November 2015
[50] Stephenson P (2015) *Op. cit.*

it is important to clearly differentiate between ESIF performance audits and evaluations as both can have similar goals and use similar methods.

The Court is involved in administrative arrangements that seek to address coordination challenges and these should also be noted**.** Cooperation between the Court and national audit institutions takes place within the framework of a Contact Committee, composed of the Heads of the national audit authorities and the Court. The Committee has established working groups, including one to oversee parallel studies on the management of Structural Funds in the MS. It should be noted that this coordination and cooperation can produce valuable results but it is a time-consuming process, particularly given the varied needs and capacities of audit systems across MS. **Thus, in debates about the simplification of audit, the issue of increased coordination and reliance on each others' work, between EU and MS levels, is crucial**.

Assessing the complexity of ESIF control and audit systems requires the disaggregation of different responsibilities across the EU and MS levels. It is important to identify the specific location of the most complex tasks. Table 3 sets out an indicative list of control and audit tasks for the ECA, MAs, CAs and AAs.

Table 3: Audit and control tasks of ESIF programme authorities

MA	CA	AA
MA responsible for managing and implementing OP with 'sound financial control'	Submitting payment applications to Commission	Give an Audit Opinion on designation of CA, MA
Projects comply with Community and National rules	Drawing up the accounts	Prepare an audit strategy
Expenditure declared by beneficiaries has actually been incurred	Ensuring existence of computerized accounting records for each operation	Carry out audits on systems
On-the-spot (management) verifications may be carried out on a sample basis		Select sample in reference to the accounting year
Ensure there is a system to record/store accounting records for each project		Carry out audits on operations
Collect information on financial management, monitoring, verifications, evaluation and audit		Carry out audits of the accounts certified by CA
Draw up and submit annual & final reports on implementation		Report to EC by 15th February each year, providing a control

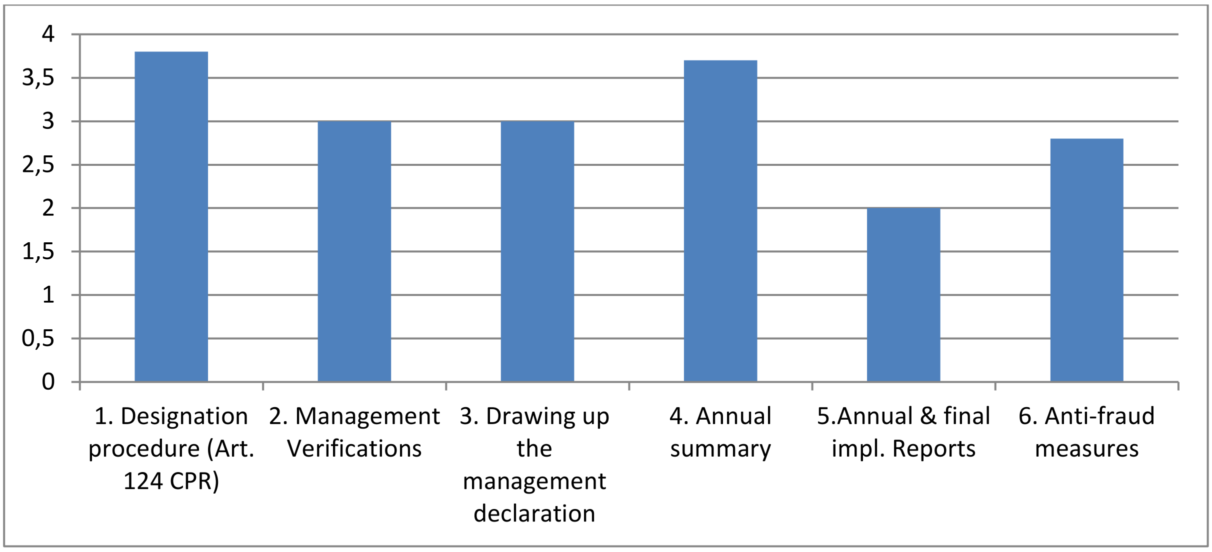
MA	CA	AA
		report and audit opinion on accounts
Effective and proportionate anti-fraud measures		
Drawing up a management declaration on the functioning of the systems, legality and regularity of transactions and sound financial management		
Drawing up an annual summary of final audit reports and verifications and controls carried out, analysis of nature of errors and corrective actions taken or to be taken		
Report to EC by 15 February each year (Art.59(5)(b) Financial Regulation)		

Source: Based on Byrne, D. (2014) 'Management and control systems' presentation organised by EIPA-Ecorys-PwC under the Framework Contract, Brussels, September 2014.

3.2. Functions of the Managing Authority

MA functions in the field of financial control and audit relate to: the designation procedure (to ensure that the MA and CA have the necessary and appropriate management and control systems set up from the start of the period); management verifications (including administrative verifications and 'on the spot' checks); anti-fraud measures; management declarations; annual summaries (of accounts on the expenditure that was incurred and audit and control procedures); and annual implementation reports. Figure 4 provides a summary of the views of the actors interviewed from the MAs of the seven case study OPs in relation to the level of complexity associated with these tasks. Interviewees were asked to rate the perceived complexity of each task on a scale 1 (limited complexity) to 5 (extreme complexity), and to discuss the reasons for their assessments.

Figure 4: Complexities facing MAs, case study views



Source: Case study research.

As Figure 4 shows, the two tasks perceived by MAs to be the most complex were the designation process and the annual summaries. The challenges associated with the designation procedure are explored in Section 3.4.1. MA views on the other tasks listed are set out below.

3.2.1 Management verifications (Art. 125 (4a), (5a), 5(b) CPR)

Under the CPR, MAs are required to verify that the ESIF co-financed products and services have been delivered and that expenditure declared by the beneficiaries has been paid and that it complies with applicable law, the Commission decision approving the OP and the conditions for support of the operation. This requirement involves administrative and 'on the spot' verifications.

- **Administrative verifications create considerable burden and complexity and could be made more proportionate.** These must be carried out for each application for reimbursement by beneficiaries, based on an examination of the claim and supporting documentation. In the view of some programme authorities, administrative verifications in respect of each application for reimbursement creates substantial complexity: the current system requires in essence, that eligibility of each euro in each invoice is verified, involving long checklists and substantial documentation. This brings the error rate down but with the cost of high bureaucracy. Commission guidance recognises that verification of each individual expenditure item against source documentation, although desirable, may not be practical. It allows, where justified, selection of the expenditure items to be verified within each application for reimbursement, to be based on a sample of transactions, selected taking account of risk factors (value of items, type of beneficiary, past experience), and complemented by a random sample. Nevertheless, Member States are wary of incurring future audit penalties and often carry out comprehensive verifications. Verifications, including those based on random sampling, are particularly complex in programmes that include a large number of small projects (noticeable, for instance in ESF-funded programmes). According to interview evidence, timely verification of expenditure in these cases has particular challenges for MAs and IBs, including providing support to beneficiaries to present this expenditure in an organised and clear manner.

- **This process can be further complicated in programmes with several IBs** as the MA is required to obtain assurance by performing quality checks on samples of verifications carried out by IBs. For some MAs interviewed, complexity is exacerbated by delayed and unclear regulations and guidance from the Commission. Beneficiaries and programme authorities would like to avoid dealing with an inordinately large volume of documentation and there is potential to introduce more proportional arrangements, for instance drawing on the findings of other external controls or requesting only the supporting documentation in respect of the sample of expenditure items selected for verification. However, there is concern that following audits, such approaches will incur penalties.

- **'On the spot' verifications are proportionate and less problematic.** The frequency and coverage of the 'on-the-spot' verifications is proportionate to the amount of public support given to an operation and to the level of risk identified by such verifications and audits of the management and control system as a whole. This means that the number of 'on the spot' visits is based on sampling and is limited. However, some problems were apparent where annual audit summary deadlines are pending and where 'on-the-spot' verifications have to be finalised in a short period of time in order to be included. In specific cases, the limited capacity of some programme bodies, especially where programme management and implementation structures have changed between programme periods has caused difficulties.

3.2.2 Anti-fraud measures (Art. 125 (4c) CPR)

- **Anti-fraud measures have been cumbersome to deliver and there has been limited application of Commission initiatives.** This is a new function for MAs and introduces additional responsibilities with legal consequences and additional workload in comparison to the previous programming period. The Arachne initiative has been designed to aid programme authorities in this work. It is a risk scoring tool developed by the European Commission in close cooperation with some Member States. The Commission services aim at supporting ESIF MAs with this Risk Scoring Tool to identify effectively and efficiently most risky projects, contracts, contractors and beneficiaries, necessary for their management verifications. For several reasons, the MAs interviewed have struggled to adapt to this new responsibility. First, it is based on a number of different regulations (e.g. CPR - 1303/2013, FRR - 966/2012, delegated regulations: 480/2014, 1268/2012 2015/1970, implementing regulation 2015/1974), several of which have undergone revisions and related guidance is also open to misinterpretation. It is complex to create and implement the anti-fraud system that will fit all kinds of projects in diversified fields and all types of beneficiaries. There are specific challenges in carrying out these tasks for ETC programmes. This requires putting together methodologies to check and prevent fraud in all the partner countries, involving the drafting of many procedures and spending a disproportionate amount of resources for programmes that often have limited budgets. The Commission guidance document on anti-fraud measures does not take into account the specific ETC context.

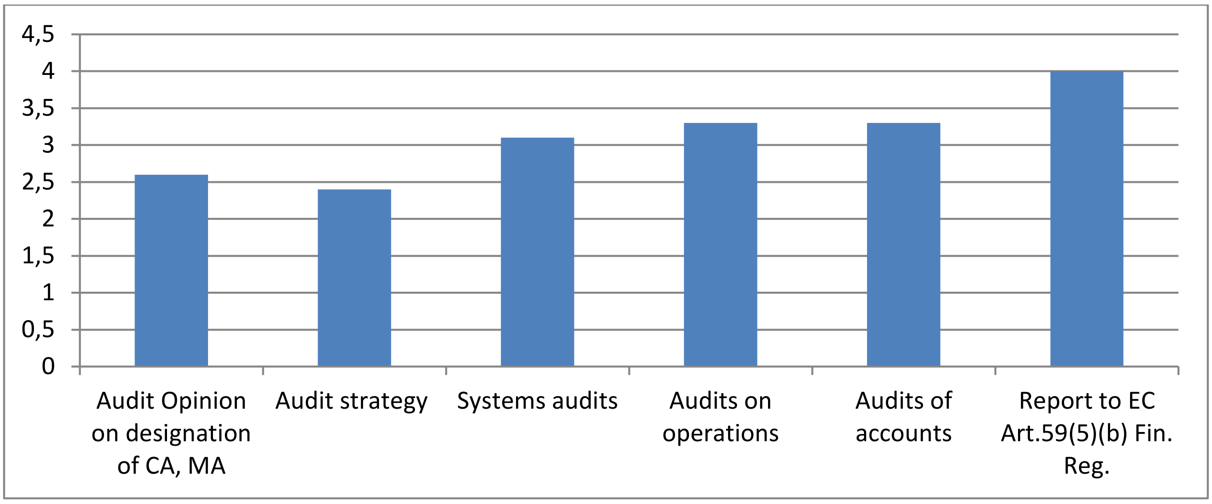
3.2.3 Management declaration and annual summary (Article 125 (4e) CPR)

- **Annual reporting has benefits but further streamlining is needed.** The drafting of an annual management declaration and summary of the final audit reports and of controls carried out is a new responsibility for MAs. Annual reporting is appreciated in principle by programme authorities. It offers a more structured approach to creating assurance over the programming period and addresses some of the complexity encountered at programme closure as there is a tendency for issues to accumulate at the end of the period. Nevertheless, it is challenging for programme authorities to implement as it has a rigid logic and timeframe that does not follow the 'real' timeline of projects. According to interviewees, MAs and IBs face problems updating information as controls and audits are ongoing throughout the year. In some cases, late publication of Commission guidelines and the need to adapt IT systems to collect data has put additional time pressure on programme authorities. Some programme authorities interviewed identify unnecessary complexity through duplication or overlaps between this task and the Annual Control report prepared by the Audit Authority.

3.3 Functions of the Audit Authority

Audit Authority functions consist of: providing an opinion on designation of the MA and CA, developing an audit strategy, carrying out systems audits, audits on operations, audits of accounts and providing an annual summary of the final audit reports and of controls carried out. Figure 5 provides a summary of the views of the actors interviewed from the AAs of the seven case study OPs in relation to the level of complexity associated with these tasks. Interviewees were asked to rate the perceived complexity of each task on a scale 1 (limited complexity) to 5 (extreme complexity), and to discuss the reasons for their assessments. As Figure 5 shows, AAs identify most complexity with the production of annual reports under Article 59(5)(b) of the Financial Regulation. AA views on this and other tasks listed are set out below.

Figure 5: Complexities facing AAs, case study views



Source: Case study research.

3.3.1 Give an Audit Opinion on designation of CA and MA and preparation of an audit strategy

- Coordination of these tasks among programme authorities has been challenging, given the level of detail indicated by EC guidance notes. In some cases, MAs submitted descriptions of the management and control systems to AAs at a very late stage, giving limited time for giving an audit opinion. These tasks can be **particularly complex for trans-national programmes that utilise ERDF as well as IPA funds** (as is the case of the ADRION programme analysed in this study). The involvement of different actors from various countries requires more complex governance arrangements. The audit strategy of the ADRION programme, for example, was prepared by the AA with the support of a so-called 'group of auditors' (GOA). This includes a member from each country represented in the programme. Audit work carried out under the programme is always agreed with this group.[51] The AA is now selecting a third party that will be charged with the realisation of audits in all the countries involved in the programme. In each country, this actor will have to liaise/coordinate with the GOA (e.g. for an audit in Croatia, consulting the Croatian GOA member before launching the audit and so on). This is creating an additional burden both from the perspective of the preparation of the audit strategy (which is more complex) and in terms of the task itself, not least for the challenge entailed in identifying an organisation with capability to operate across the entire programme area. The necessity to put in place such complex arrangements is also causing delays: an already long and stringent timetable is made worse by this complexity.

3.3.2 Carry out audits on systems

- **Systems audit requires significant capacity, especially in large, complex programmes.** Carrying out audits of systems and operations demands significant capacity and experience in AAs, especially in programmes such as the OP Infrastructure and Environment where there are a large number of operations, many of which involve complex, major infrastructure projects. Several AAs place significant emphasis on the audit of management and control systems as they can then draw assurance that the operations selected for implementation, even if they are complex and potentially risky, are likely to be implemented successfully.

3.3.3 Carry out audits on operations

- **Statistically representative sampling creates more assurance but makes audit work more complex**. Article 28 of Commission Delegated Regulation (EU) no 480/2014 sets a methodology for the selection of the sample of operations. This calls for the AA to draw a statistically representative sample from the population of operations covered. Non-statistical sampling can be applied, but must be justified to the Commission, must cover a minimum of 5% operations and 10% of the expenditure declared, and the AA must be able to extrapolate the results to the population from which the sample was drawn. Statistically representative sampling aligns ESIF auditing approaches with internationally accepted standards and it also makes the conclusions of audit reports more robust. Nevertheless, it makes the work of AAs demanding, notably through the requirement that AAs submit opinions based on a

[51] Regulation (EU) No 1299/2013 of the European Parliament and of the Council of 17 December 2013 on specific provisions for the support from the European Regional Development Fund to the European territorial cooperation goal.

statistically representative samples of operations. Some AAs acknowledge that the Commission has provided guidance on approaches to developing samples, but find the various methodologies complex. Nevertheless a question remains if programmes could do with simple random sampling, without aiming for the complex extrapolation methods required by the current regulatory framework. Constraining the scope for non-statistical (for instance, 'risk based') sampling limits opportunities for proportionality. This applies particularly to programmes with many beneficiaries using relatively small levels of funding.

3.3.4 Annual control report and audit opinion on accounts

- **The requirement for annual audit reports lessens complexity at the end of programme periods but creates time pressures**. Every year the AAs must issue an annual control report, giving their opinion with reference to the results of the audits. Representatives of AAs interviewed recognised benefits in 'annual closure': it eases administrative burdens at the end of the programme period and addresses the accumulation of problems at the stage of programme closure. On the other hand, it creates time pressures in compiling the report every year and ensuring the inclusion of the relevant audit results. The time frame between certification of accounts on 1 July, and submission of the audit opinion and annual control report by 15 February the following year is very tight for delivering the audits, doing the contradictory phase, putting into practice action plans and ensuring the necessary follow-up. This challenge has been exacerbated by changing guidelines from the Commission, with increasing level of detail required in Annual Reports. **Some AAs saw the reduction in the time allocated for sending the control report and audit opinion to the Commission, from one year to around 6-8 months, as the most complex problem they are facing.**

3.4 Cross-cutting issues

3.4.1 Designation Procedure

For 2014-20, a new national designation process for the MA was established. In contrast to 2007-13, this designation process was only to be reviewed by the Commission in three cases: where the total amount of support from ESIF under the related programme exceeds a certain amount, following a risk analysis or at the Member State's initiative. It was to be a largely formal, 'tick box' process, and MS could simplify the process if the system was the same as that used in 2007-13.

- **Designation does not really provide complete assurance on the functioning of systems**. It is important to have a designation process but interviewees emphasised that this should not be seen as an assurance of robust systems for the entire programming period. The system may appear robust but this may only be a 'snapshot' at a particular time. In some Member States, there is considerable flux and it is challenging to get assurance as systems are modified.

- **Designation is seen as more complex than in 2007-13**, with lengthy guidance and checklists provided by the Commission, so that the process is seen to be **at least as complex as the process of drafting and agreeing the OP itself.** The rules are seen as unclear, partly because there are so many different EU documents (regulations, delegated and implementing acts, guidelines…) so that OP authorities need to combine rules from different documents in order to understand what needs to be done.

- **Designation is taking a very long time across all EU Member States, which in turn is leading to delays in financial implementation** because only advance payments can be made until designation is complete.

- In theory, the designation process should not create excessive complexity: provisions for proportionality were included. However, **Member States have preferred a 'heavy' procedure to guarantee assurance and limit the scope for retroactive audit measures.** In practice, MS have tended to go for a 'heavier' approach and call for Commission reviews. This not only contributes to complexity for programme authorities (i.e. responding to Commission checks) but also puts a strain on Commission capacity as it is stretched to cover many programmes. This approach can be the result of risk aversion, a cautious approach from MS and programme authorities, based on concern about future controls and penalties.

- **Replacing Commission with MS approval of designation does not mean simplification: the procedure is more time-consuming and labour-intensive than in 2007-13.** According to some MAs, disproportionate work is needed to document and approve the management and control system. The quantity of documentation required and the degree of detail required has increased compared to 2007-13. For some programme authorities, the checklist for the designation report is excessive and goes beyond regulatory requirement. There is also some duplication with the systems audit. Addressing these challenges has created delays in the designation process which in turn has held back the launch of some OPs, with negative implications for performance.

- **The procedure does not take into consideration the specificity of ETC and especially the fact that the MA is representing several MS**. Compared to mainstream programmes, the analysis of the management and control systems is more complex, due to the many systems and actors involved, from different countries (some of which, in the particular case of the case study programme reviewed, are outside the EU).

- **More fundamentally, the allocation of responsibility to Member State authorities creates additional challenges**. Lines of accountability between Member State audit authorities, the Commission and the ECA can be unclear given the lack of legal clarity and certainty over some rules.

3.4.2 Types of operation

It is also important to note that the degree of complexity varies in terms of what is being audited. Some operations are more straightforward (e.g. with limited scope for error in terms of eligibility) but there are complexity issues with specific types of project:

- **Management and control of Financial Instruments and revenue-generating projects is inevitably complex** and the capacity and experience of programme authorities (and Commission bodies) is sometimes limited. It is challenging to establish legal certainty under FIs and the introduction of specific regulatory provisions to take this into account creates complexity. For instance, Article 9 (3)(a) of Commission Delegated Regulation (EU) No 480/2014 contains detailed rules governing the control of FIs implemented by the European Investment Bank, specifying in this case the obligation to choose an external company. This is a departure from the general principles of the FI management and control system and from the broader system of audits and checks of beneficiaries in some MS. According to some programme authorities interviewed, this complicates the process of implementing FIs, potentially delaying their implementation, and leads to an unjustified increase in operating costs (due to the remuneration payable to an external firm).

Programmes with other types of intervention also face complexity:

- **OPs that include major infrastructure projects** can face complex control and audit challenges (e.g. concerning public procurement issues).
- **OPs with small budgets or that include a high proportion of small operations,** where the operational costs of individual control and audit procedures involving small amounts of funding must be weighed against the effects.

- **However, introducing simplification for some types of project in a differentiated way could in itself contribute to complexity.** Programme authorities in some MS have noted that adding elements to the existing regulatory framework with the intention of creating 'simpler' procedures for certain types of project, leads to multiple sets of rules and so to increased complexity.[52]

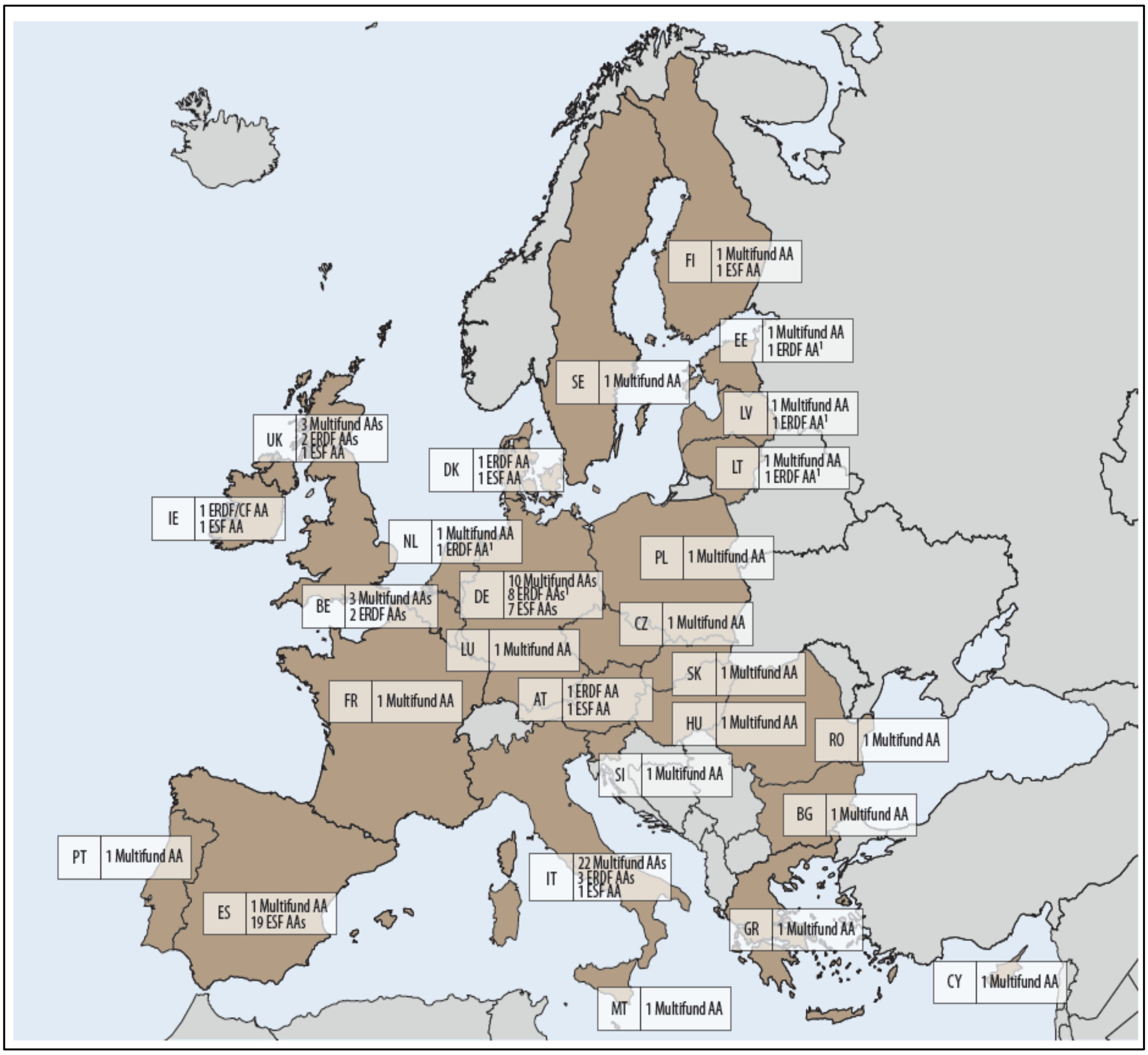
3.4.3 The Member State context

Levels of complexity are in part dictated by domestic institutional environments in MS. This relates to: the allocation of management and control responsibilities across ESIF programmes; the strength and experience of domestic control and audit activities; and, the relationship between EU and domestic regulations (including the extent of gold-plating).

- **There is variation in the allocation of financial control and audit responsibilities across MS, depending on domestic institutional arrangements and the architecture of ESIF programmes**. Figure 6 sets out the number and type of AAs in MS in 2012.

52 Davies S (2015) *Op. cit.*

Figure 6: Number and type of Audit Authorities per Member State (2012)



Source: ECA (2013) *Op. cit.*

- **Broadly speaking, these responsibilities can be centralised at different levels (MS, regional, programme).** In terms of finding a balance between achieving assurance and limiting complexity, each system has its advantages and disadvantages. Some systems may work better in some Member States and worse in others. Each system has its advantages and disadvantages.

    - **Centralised systems** are often slow compared to de-centralised systems. For addressing complexity, an advantage of centralised approaches is that there are a limited number of controllers, and that they can be informed and trained to consistent standards relatively simply.
    - **Decentralised systems** use a higher number of audit bodies. These can produce quicker results with a clearer picture of issues 'on the ground'. Nevertheless, it is more complex to enforce standard practices across many AAs. For this reason, the quality of the process can vary substantially from one controller to the next. In some cases, e.g. in Italy, a decentralised system with regional AAs is complemented by national coordination, realised by the General Inspectorate for financial relations with the European Union at the Ministry of Economy and Finance (IGRUE). The

implementation of rules, good practice experiences and common challenges are discussed within regular meetings involving all AAs and IGRUE representatives.

- **Institutional stability helps to limit complexity.** Previous research on Cohesion policy administration indicates the importance of stability for efficient implementation, emphasising the need for timely reorganisation and continuity of personnel whatever the organisational changes.[53] The risk of error and complexity in financial control and audit increase where institutional arrangements are in flux or staff turnover is high. Lack of experience and institutional memory at different levels can be particularly problematic for control and audit, given the considerable level of technicality of the tasks involved. Conversely, programme authorities have noted the benefit of strong, stable relations between MAs, IBs and AAs in dealing with complex challenges, including through informal contacts.

- **Responsibilities can be sub-contracted but this depends on the strength and experience of domestic actors in these fields.** In some of the case studies covered in this research, outsourcing of management tasks simplifies the work of programme authorities and carries little risk as there is a large, developed market of trusted consultants. This does not apply in Member States with limited experience of Cohesion policy management and with smaller, less developed consultancy markets. Indeed, in some contexts, ESIF control and audit requirements have a capacity-building effect. Some beneficiaries have developed substantial new systems and capacities to ensure transparency and regularity in their operations as a result of meeting EU regulations and guidance. In these contexts, programme authorities encourage exchange of experience among beneficiaries for this purpose of building capacity.

- **Relationship between domestic and EU regulations.** A fundamental characteristic of the ESIF shared management system is the interaction of EU and domestic regulations. The complexity created by this interaction varies across Member States depending on the degree of alignment between EU and domestic regulatory frameworks, administrative cultures and traditions, previous audit experiences etc. To give an example of these different traditions from our case study research, the same territorial cooperation project can have four pages of guidance on one side of a national border and 40 pages on the other side. In some countries, levels of domestic assurance and administrative capacity mean that Commission guidance is used in a selective way, targeting the relevant issues and procedures. However, in countries where this capacity is lacking, Commission guidance is fully incorporated in detail. This produces a comprehensive but complex set of rules for programme authorities. This distinction between MS cases should not be perceived as a straightforward split between 'more developed' and 'less developed' examples. There are specific cases where complexity is the result of specific dysfunctions in administrations (e.g. tensions and lack of trust between institutions caused by institutional or political rivalries).

- **Gold plating,** i.e. the introduction of additional administrative procedures and regulatory obligations that go beyond the ESIF requirements set out at EU level, is a cause of complexity in financial control and audit processes. Recent research has

[53] Wostner P (2008) 'The Micro-efficiency of EU Cohesion policy' *European Policy Research Papers*, No 64, European Policies Research Centre, University of Strathclyde, Glasgow.

found evidence of 'gold-plating' in the presence of additional requirements related to financial controls.[54] It finds cases where the financial control on ESIF is more rigid than required by ESIF regulations, including: more rigid controls in terms of application of lower thresholds or stricter rules when conducting public procurement procedures; additional control procedures at various steps of programme implementation, additional criteria to be proven by beneficiaries to obtain an audit exemption; and stricter interpretation of eligibility criteria than required by regulations. However, it should be noted that in some case studies covered in this research, programme authorities have seen efforts to streamline procedures resisted by the Commission. Case study research for this study identified cases where MS initiatives to simplify procedures by relying on checks by domestic authorities (e.g. under public procurement) were opposed by the Commission: programme authorities were required to carry out their own checks, effectively duplicating tasks and creating 'gold plating'.

3.4.4 Role of EU-level institutions

Of course, EU-level institutions play a fundamental role in deciding the balance between the requirements for financial control and the need to limit complexity. This relates to: setting the regulatory framework and providing guidance; and, carrying out audits and controls (by European Commission and ECA).

- **Lack of a standardised approach to the regulations governing EU instruments under shared management (ESIF) and direct management (e.g. COSME, Horizon 2020) constrains the pursuit of synergies and creates complexity.** Inconsistency in the treatment of similar projects across EU instruments creates practical difficulties that make it more difficult to use ESIF in a way that is complementary to centrally managed instruments. This includes challenges involving:

    - **Public procurement**. Public procurement rules are not specific to Cohesion policy. However, dealing with public procurement issues is a significant challenge, due to the interaction of domestic and Commission regulations and the accumulation of myriad rules. Managing Authorities have to take into account domestic regulations and Commission directives on public procurement and this creates a complex system, often with duplication and excessive checking of details for beneficiaries. The complexity of EU, national and regional rules and their frequent changes at the national and regional level has been cited as a cause of errors in public procurement.[55] This acts as a disincentive for beneficiaries who see the system as punitive. A particular challenge for ESIF is that – in particular in comparison to national subsidy schemes – several layers of control are at work. Thus the probability to detect infringements of PP rules is higher. Some smaller programme authorities address this complexity by using the services of external specialist companies, though this is not possible in all contexts and does not exonerate programme authorities from responsibility for possible

[54] Spatial Foresight et al. (2017) *Gold-plating in the European Structural and Investment Funds* Research for European Parliament REGI Committee.

[55] Working Group on Structural Funds (2016) *Report to the Contact Committee of the heads of the Supreme Audit Institutions of the Member States of the European Union and the European Court of Auditors on the parallel audit of Analysis of (types of) errors in EU and national public procurement within the Structural Funds programmes.*

errors. The views gathered through the case study research undertaken for this study indicate that errors in public procurement appear to be mainly the result of genuine mistakes resulting from complex rules. As a result, project promoters are frustrated by ex-post audits, which often arrive at a late stage in proceedings, when fixing mistakes is no longer possible and when they do not have the possibility to ask for a provisional binding ruling.
- **State aid**. While programmes managed centrally by the European Commission are exempt from state aid procedures, funding under ESIF is not exempt and the situation is very complicated for beneficiaries and MAs.[56] State aid is often subject to different interpretations in different Member States: there is no clear, comprehensive interpretation of State aid, with judgements being based solely on individual applications and findings. This again leads to the accumulation of myriad sets of rules and guidance without achieving adequate legal certainty.

- **Need for clear and timely guidance.** A common cause of complexity noted by programme authorities is the provision of EU guidance, including:

  - **Proliferation of documentation**. A basic problem is the accumulation of documents and guidance notes produced by the European Commission at different points in time and coming from different sources. Over time, a mass of 'secondary documentation', consisting of guidance and interpretation of regulations has developed (e.g. on sampling methodologies or audit strategies). The problem is exacerbated by the fact that there are often no dates in documents and so it is not clear what the most up to date guidance is. This accumulation is in part explained by a dynamic whereby errors detected in a specific programme trigger guidance from the EU-level that is then applied horizontally across all programmes, creating extra checks and also administrative burden where those elements are already compliant. As this guidance builds up, the administrative burden and complexity increases for all programme authorities and beneficiaries, and the scope for further error also increases.
  - **Lack of clarity**. Commission guidance is often open to various interpretations. It is arguable that this encourages flexibility in adapting EU-level requirements to programme-specific conditions. However, programme authorities often react to uncertainty and perceived risks by maximising safeguarding measures, trying to prevent their decisions from being challenged by other institutions in the system.

  - **Ambiguous legal status, uncertainty**. Formally, Commission guidance is not legally binding but in practice, MAs and IBs are concerned that auditors may act under a stricter interpretation of the guidelines and treat some of them as obligatory. For instance, making the management declaration and annual summary is an important new responsibility for the MAs but some authorities found the guidance vague: it included

[56] Committee of the Regions (2016) *Simplification of ESIF from the perspective of Local and Regional Authorities - opinion*, 119th plenary session, 10, 11 and 12 October 2016.

examples of best practice and some general suggestions but was not transparent on what the strict MA obligations are.

  - **The need for timeliness**. Commission guidelines are often published very late. Some important guidance, notably on the Annual Closure process, was not issued by the Commission until the second half of 2015.

- **Coordination and consistency in control and audit procedures**. Coordination and consistency in audits **is crucial in limiting complexity**, given the different levels of control to which ESIF programmes and operations are subject. Table 4 sets out the audit of operations carried out under different ESI funds in 2015 alone. The role of the European Commission and ECA is important in this. Experience across MS varies in this respect. Some programme authorities noted the difficulties caused by multiple visits from auditors from MS and EU levels which can use different methodologies and produce different assessments. Other authorities have found the visits of different EU bodies to projects to be well coordinated. It is also worth noting current initiatives to increase the cooperation between the Commission and the ECA in developing consistent methodological approaches and in drawing on each other's results in developing assessments, already discussed[57].

Table 4: Audit of operations by the AAs (representative sample) in 2015

	No. OPs	No. operations	No. operations audited	% audited operations	% audited amount
ERDF/CF	322	249 361	7 294	<3%	29%
Average/OP		774	23		
ESF	118	832 025	4 976	<1%	15%
Average/OP		7 051	42		

Source: Sébert, F. (2016) 'Audit of ESF and ERDF ', presentation at *High Level Expert Group meeting* 29/11/2016.

[57] European Court of Auditors (2017) *Background paper: The ECA's modified approach to the Statement of Assurance audits in Cohesion*, 14.12.2017.

4. CONTROL AND AUDIT IN THE SIMPLIFICATION AGENDA: WHAT IS WORKING?

SUMMARY OF KEY FINDINGS

- As with previous regulatory packages, the CPR introduced a number of measures intended to simplify procedures and reduce the complexity associated with financial control and audit.
- In 2017, the European Commission and the European Parliament have both restated the need to reconsider arrangements for simplifying control and audit.
- Cutting across this issue is the Commission's 'Better Regulation Agenda', a package of reforms adopted in 2015 to: boost transparency in the EU decision-making process; improve the quality of new laws through better impact assessments of draft legislation; and, promote constant and consistent review of existing EU laws, so that EU policies achieve their objectives in the most effective and efficient way.
- Programme authorities recognise the need for effective rules in order to avoid errors, fraud and the misuse of funds and welcomed the basic principles on which these measures are based. Nevertheless, OP authorities continue to call for greater simplification of OP financial management and proportionality in audit and control.
- Recent research conducted among programme authorities in different MS for the IQ-Net Network highlighted some key issues related to: (i) the persistent lack of legal certainty; (ii) the need for more proportionality and legal certainty; (iii) the need to clarify further the legal framework and operationalisation of SCOs; (iv) a number of other specific issues related to audit and control procedures, for example in relation to sampling methods and the timing of these activities.

4.1 ESIF simplification and control 2014-20 – key measures

Over the years, there has been increased awareness of the 'perverse effects' of ESIF control and audit, in terms of increasing the complexity of implementation and reducing the efficiency and effectiveness of programmes. As a result, a simplification agenda has accompanied each policy reform debate since 1999, with control and audit at the heart of proposals for simplification and streamlining of procedures.

As with previous regulatory packages, the CPR introduced a number of measures intended to simplify procedures and reduce the complexity associated with financial control and audit.[58] The Commission published a draft working paper in 2011 on simplification in the Cohesion policy regulations for 2014-20, which set out proposed changes.[59] This was followed in 2012 by a Commission communication on simplification in the Multi-annual Financial Framework,[60] and by a brochure targeted at beneficiaries and Managing

[58] For a review see Davies S (2015) *Op. cit.*; and, EPRC (2016) 'The simplification of EU Cohesion policy: Problems and Priorities for Change', *IQ-Net Briefing,* January 2016, European Policies Research Centre, University of Strathclyde, Glasgow.

[59] European Commission (2012) *Op. cit.*; European Commission (2011) *Simplification in the legislative framework for Cohesion policy for 2014-2020*, Draft Working Paper, Fiche no 9, Brussels, 18.11.2011.

[60] European Commission (2012) *A Simplification Agenda for the MFF 2014-2020*, Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Brussels, 8.2.2012, COM(2012) 42 final.

Authorities.[61] In addition, various studies on this theme were undertaken for the European Commission,[62] the European Parliament[63] and the Committee of the Regions.[64] Based on the shortcomings that emerged during the 2007-13 period, the 2013 CPR adopted a number of innovations aimed at simplifying control and audit requirements (see Table 2).

In 2017, the European Commission and the European Parliament have both restated the need to reconsider arrangements for simplifying control and audit. This applies to the remainder of the period and the future, reviewing the operationalisation of shared management in order to avoid the delays that are characterising the current programme cycle, and render all procedures more manageable for the authorities in charge of the funds and programme beneficiaries.[65] A High Level Group on Simplification, established by the Commission in July 2015,[66] has formulated a number of recommendations on simplification in a number of areas,[67] including control and audit (see Section 1.3). At the end of 2016, the Commission, in the framework of the mid-term review/revision of the multiannual financial framework (MFF) 2014-20, proposed a new Omnibus Regulation. This amends several regulations on the implementation of EU policies in 2014-20 (including the CPR applicable to Cohesion policy) and the financial rules applicable to the general budget. A stated goal is to pursue further simplification and flexibility for the remainder of the programming period (2017-20).[68] In this new Omnibus Regulation, the Commission restated that sound financial management remains a key objective of EU financial rules. The new regulation seeks to strengthen the systems in place to protect the EU budget against fraud and financial irregularities, and contributes to reduce the administrative burden of programme implementation and the number of errors, in so doing also supporting a higher impact of EU policies on the ground.[69]

Cutting across these issues is the Commission's 'Better Regulation Agenda', a package of reforms adopted in 2015 to boost transparency in the EU decision-making process, improve the quality of new laws through better impact assessments of draft legislation, and promote constant and consistent review of existing EU laws, so that EU policies achieve their objectives in the most effective and efficient way. Notably, it advocates

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61 European Commission (2012) *Simplifying Cohesion policy for 2014-2020,* Brussels, p. 3.

62 t33, Archidata, Berman Group, CSIL, Infyde, Laboratorium Rozwoju, METIS, and SWECO (2012) *Measuring the impact of changing regulatory requirements to administrative cost and administrative burden of managing EU Structural Funds*, Report to the European Commission, Brussels.

63 For instance, see Mendez C, Bachtler J and Wishlade F (2012) *Cohesion policy after 2013: A critical assessment of the legislative proposals*, Report to the European Parliament's DG for Internal Policies, PE 474.558, Brussels.

64 Dhéret C, Zuleeg F and Chiorean-Sime S (2012) *EU Financial Regulation: Analysis of the simplification measures mentioned in both the proposal for a EU Financial Regulation and the Cohesion policy legislative package*, Report by the European Policy Centre for the Committee of the Regions, Brussels.

65 European Commission (2016a) *Op. cit.*; European Parliament (2017a) Resolution of 16 February 2017 on investing in jobs and growth – maximising the contribution of European Structural and Investment Funds: an evaluation of the report under Article 16(3) of the CPR (P8_TA -PROV(2017)0053); European Parliament (2017b) Resolution of 16 February 2017 on delayed implementation of ESI Funds operational programmes – impact on Cohesion policy and the way forward (P8_TA-PROV(2017)0055); European Parliament (2016a) Resolution of 11 May 2016 on acceleration of implementation of Cohesion policy (P8_TA(2016)0217); European Parliament (2016b), Resolution of 6 July 2016 on synergies for innovation: the European Structural and Investment Funds, Horizon 2020 and other European innovation funds and EU programmes (P8_TA(2016)0311); and European Parliament (2015) Resolution of 26 November 2015 'Towards simplification and performance orientation in Cohesion policy 2014-2020' (P8_TA(2015)0419).

66 'High Level Group of Independent Experts on Monitoring Simplification for Beneficiaries of the European Structural and Investment Funds'.

67 These include e-governance, simplified cost options, easier access to EU funding for SMEs, financial instruments, gold-plating, and control and audit.

68 European Commission (2016b) *Proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union*, Brussels, 14.9.2016, COM(2016) 605 final, 2016/0282 (COD).

69 European Commission (2016a) *Op. cit.,* p. 3.

a 'Fitness Check': a comprehensive assessment of a given policy area that addresses how several related legislative acts contribute to the attainment of policy objectives. This process can identify overlaps, inconsistencies synergies and the cumulative impacts of regulation. As part of this, the REFIT Platform brings together the Commission, national authorities and other stakeholders in regular meetings to improve existing EU legislation. The aim is to keep the entire stock of EU legislation under review and ensure that regulatory burdens are minimised and that all simplification options are identified and applied.[70]

4.2 Experiences in 2014-20

Responses from programme authorities have recognised the **need for effective rules in order to avoid errors, fraud and the misuse of funds and welcomed the basic principles on which these measures are based.** Nevertheless, OP authorities from across the EU **continue to call for greater simplification of OP financial management and proportionality in audit and control.**[71] Doubts have been expressed as to whether they will lead to genuine simplification in practice.

Recent research conducted among programme authorities in different MS for the IQ-Net Network highlighted some key issues related to: (i) the persistent lack of legal certainty; (ii) the need for more proportionality and legal certainty; (iii) the need to clarify further the legal framework and operationalisation of SCOs; (iv) a number of other specific issues related to audit and control procedures, for example in relation to sampling methods and the timing of these activities (Box 1). [72]

Box 1: Experiences with simplification in 2014-20 in IQ-Net programmes

1. Continued lack of legal certainty

Many programme authorities continue to experience a lack of legal certainty due to unclear and complex rules, which was seen to imply a transfer of audit risk from the Commission to domestic OP authorities, potentially leading to programme interruptions and suspensions. Key issues include:

Multiple EU-level legal and guidance documents – and the lack of consistency between them (Common Provisions Regulation, Fund regulations, Implementing Acts, Delegated Acts, Guidelines…), so that OP authorities have to combine and interpret the different texts;

Delays when Managing Authorities submit queries to the Commission on specific questions relating to legal certainty;

A lack of stability over time in rules (e.g. on State aid and revenue-generating projects in 2007-13) and in the EU authorities' interpretations of rules;

Retroactive decisions, with EU authorities re-interpreting rules in a stricter light at a later point in time and applying the new interpretation to previous years;

Insufficient Commission guidance on the application of new initiatives, which may therefore not be fully exploited due to concerns over legal certainty;

A reluctance to use national eligibility rules, because of a perceived risk that the Commission could introduce future rules which differ from the national approach.

[70] European Commission (2015) *Commission Staff Working Document – Better Regulation Guidelines*. Document SWD(2015) 111 final.

[71] Lehuraux T (2017) 'Gathering implementation speed: the progress of Structural Funds programmes', *IQ-Net Review Paper* 40(1), European Policies Research Centre, University of Strathclyde, Glasgow.

[72] See Davies S (2015) *Op. cit.* for a detailed assessment of these issues.

Due to concerns over legal certainty and clarity in the context of financial control and audit, the regulations are now accompanied by a **proliferation of delegated acts, implementing acts, and Commission guidance** notes.

2. Coordination and proportionality

The layers of checks i.e. of the beneficiary is accountable to the intermediate body, which is accountable to the MA, which is accountable to the audit authority and the Commission, while the audit authority is accountable to the Commission and the European Court of Auditors, and the Commission is accountable to the European Parliament and European Court of Auditors; moreover, these EU layers of checks operate alongside parallel domestic layers of checks;

Commission's tendency to micro-manage implementation across OPs;

Simplification has consisted of adding elements to the existing framework (with 'simpler' procedures applying only to certain types of project) – which leads to multiple sets of rules and so to increased complexity. For example, although the idea of Simplified Cost Options may be attractive to programme authorities it can only be applied in the case of grants and repayable assistance (Article 67(1) CPR) and not where an operation or a project forming part of an operation is implemented exclusively through public procurement (see Article 67(4) CPR and section 1.6.2, page 11). SCOs are also more viable where reliable data on financial and quantitative implementation of operations are available or where the operations belong to a standard framework. As a result, programme authorities find that the rules for implementation must be set twice: first, for the "full" alternative, second, for the simplified option.

A perception that there has been a transfer of audit risk from the Commission to national/regional AAs and MAs and beneficiaries, generating uncertainty and caution about future audit consequences.

3. Simplified cost options

Many programme authorities have adopted simplified cost options, which are seen as helpful, although preparatory work is onerous. **The benefits recognised by OP authorities** include: (i) reducing the workload for the beneficiary (particularly during the payment phase); (ii) speeding up payment processing and reducing the need for clarifications, and (iii) reducing the error rate.

Nevertheless, **some programme authorities have experienced a series of difficulties** with SCOs:

Legal uncertainty. For some OP authorities, the Commission has not provided enough guidance and has been slow to respond to queries. There is also a lack of clarity about which aspects require Commission approval. As a result, some OPs have decided not to use (some) SCO (e.g. unit costs), adopted methods in other EU funding streams (e.g. Horizon 2020 and LIFE), notably flat-rates, or cooperated with domestic authorities on methods and data sources.

Administrative burden. The work involved in establishing methodologies and data sources for calculating SCO is considerable and time-consuming (e.g. related to the use of unit costs, definition of personnel costs, state aid and public procurement issues etc.) as was the communication process with the Commission. Some MS have set up units to work with OP authorities to develop methods and implement SCO, developed national guidance and eligibility rules for MAs; or brought in external expertise in developing methods and data sources. It can be anticipated that the administrative burden involved will decline in the future if similar rules are applied. Nevertheless, the amount of work involved has hindered the broader use of SCO in some cases.

Treatment of SCO in audit. There is concern that the use of SCO can create audit problems. Audit of operations supported under SCO in 2007-13 raised subsequent issues (e.g. in relation to procurement, project eligibility period, VAT, flat rate staff costs etc.).

4. Other specific issues

Document retention periods have been reduced to assist beneficiaries, but are now more complex, with dates varying by Fund and size of project, so that the MA now has to work out document retention dates case by case and communicate these dates to beneficiaries individually.

This approach is seen to create an additional administrative burden, as well as an increased risk of error (also because many beneficiaries receive both ERDF and ESF funding, where document retention periods differ);

The **mandatory annual closure of operations** in the annual clearance of accounts is seen to generate a high administrative burden and to lead to a risk of artificial closures that are not linked to actual finished project or programme activities.

Risk-based methods of sampling for controls. This change was seen as beneficial, at least in principle, although there were concerns in practice and calls for better and more consistent sampling. Although individual beneficiaries (e.g. with 'less risky' projects) may be audited less, risk-based sampling does not reduce the burden for OP authorities e.g. because the domestic audit authority will still have to audit the same number of projects. Smaller or less risky projects may not benefit from this change in practice because, in order to sample (e.g. expense) documents, there needs to be a larger pool from which the sample can be drawn and so all beneficiaries will still need to submit expense documentation.

Smaller projects audited only once before closure. While this change is seen as helpful, some projects still face multiple audits.

Scope to reduce controls and audit intensity. IQ-Net interviewees did not believe that changes in 2014-20 allowed much scope to reduce controls and audit intensity in practice. A particular concern was the disproportionate burden on smaller OPs, which have to fulfil the same requirements as large OPs but with less funding.

5. MS initiatives in 2014-20 to address complexity

In addition to simplification measures introduced at EU level, Member States and regional authorities have also taken the initiative to find ways of simplifying Cohesion policy implementation. Key measures involve efforts to:

Revise domestic legal frameworks to reduce overlap with EU rules. One reason for the administrative burden facing OP authorities and beneficiaries is the need to meet both EU and national/regional legal requirements. This has prompted some MS to simplify domestic frameworks and/or to harmonise these with EU regulations. Nordrhein-Westfalen has introduced a Land ERDF Framework Regulation in 2014-20 which effectively transposes EU legal requirements into domestic law, so that projects co-funded by the ERDF must only meet these rules (e.g. in relation to monitoring and control), and not the 'normal' domestic legal requirements. This change also facilitates the use of simplified cost options, which are administratively difficult under domestic law. In Portugal, the number of national regulations has been reduced from c.100 in 2007-13 to six in 2014-20 (one national regulation for all ESIF, one regulation for the ESF, and one regulation for each of the four themes of the Partnership Agreement).

Reduce the numbers of OP authorities. Some MS have taken steps to reduce the number of entities involved in management and implementation, often seen to have been a challenging process or to have required high-level political decisions. Reductions sometimes focus only on the number of intermediate implementing bodies (e.g. in the Czech Republic and Scotland), or also on the number of MAs and programmes (e.g. in Austria, Finland and England).

Reduce complexity for beneficiaries. Some MS have taken steps to ease the complexity faced by beneficiaries as a result of financial control and audit. An important question in this context is whether simplification for beneficiaries inevitably creates more complexity for programme authorities as they seek to 'hide the wiring' and present a simple offer for potential applicants. Initiatives include: simplifying eligibility rules and project application forms (e.g. Wales, Denmark); harmonised information points and increased support for applicants; and, simpler and clearer procedures, including fewer interventions (e.g. streamlining of competitive calls in Nordrhein-Westfalen, use of a 'strategic intervention' approach and 'lead partners' in Scotland).

Source: Davies, S. (2015) *Op. cit*.

5. CONTROL AND SIMPLIFICATION IN THE POST-2020 DEBATE

SUMMARY OF KEY FINDINGS

- The need for simplification in the management and control of ESIF is now a central topic in the debate on reforming the policy after 2020. This is reflected in a range of EU initiatives, including European Parliament resolutions[73] and studies.[74]
- Calls to simplify the rules that govern the EU budget have also been made by the European Court of Auditors, while underlining at the same time the utmost importance of undertaking careful impact assessments of existing and prospective measures, in order to appreciate the impact and implications of any forthcoming reform.
- In July 2017 the HLG on Simplification made 12 recommendations on controls and audits for post-2020, which were part of a wider set of conclusions that included recommendations also on the streamlining of the shared management system, of legislation and guidelines, and of the rules across different funds.
- The key underlying theme is the need to reduce the costs of administering the funds while retaining the positive trend in the reduction of error rates.
- An important question is whether and how a differentiated approach could be designed that moves away from the one-size-fits-all model of shared management and which recognises that different models may be appropriate for different contexts.
- A further question relates to the extent to which harmonisation of rules across ESIF, and a move toward a single set of rules for shared management funds, can support simplification.

The need for simplification in the management and control of ESIF is now a central topic in the debate on reforming the policy after 2020. The Seventh report on economic, social and territorial cohesion noted that the policy has become increasingly complex to manage, calling for a "radical approach to simplifying implementation" is needed.[75] The complexity of administration is an ongoing challenge, particularly in the area of audit and control, and there have been a plethora of events organised on this theme and documents published. A range of studies and statements, including from the Commission, the European Council, the European Parliament, the Committee of the Regions, as well as expert groups, academics and interest groups have reviewed options for a more fundamental and systemic simplification, involving a rethink of budgetary discharge requirements and responsibilities.[76] Calls to simplify the rules that govern the EU budget have also been made

[73] European Parliament (2015) Resolution of 26 November 2015 'Towards simplification and performance orientation in Cohesion policy 2014-2020' (P8_TA(2015)0419).

[74] Bachtler J and Polverari L (2017) *Building Blocks for a Future Cohesion policy – First Reflections, Report to the European Parliament*, Directorate General for Internal Policies, Policy Department B: Structural and Cohesion Policies.

[75] European Commission (2017) *My Region, My Europe, Our Future*, Seventh report on economic, social and territorial cohesion, Brussels, September 2017.

[76] See, for instance Creţu C (2016) *Speech of Commissioner Corina Creţu at the European Union Cohesion policy Conference, Slovak Presidency of the EU*, 16.09.2016, Bratislava; EPRS (2017) 'Challenges for EU Cohesion policy Issues in the forthcoming post-2020 reform', *EPRS Briefing* February 2017; High Level Group on Simplification (HLG) (2017) *Final conclusions and recommendations of the High Level Group on Simplification for post 2020*, and key recommendations of the High Level Group of Simplification, available at: http://ec.europa.eu/regional_policy/en/information/publications/reports/2017/esif-simplification-hlg-proposal-

by the European Court of Auditors,[77] while underlining at the same time the **utmost importance of undertaking careful impact assessments of existing and prospective measures**, in order to appreciate the impact and implications of any forthcoming reforms. In fact, while the simplification of ESIF has been on the agenda since at least the mid-2000s, concerns about complexity remain,[78] and indeed the actors involved in the delivery of programmes perceive the administrative burden as having increased, rather than reduced, over time. Indeed, while the 2013 regulations did introduce some simplification measures, these were counterbalanced by new, sometimes complex requirements, such as the need to comply with ex ante conditionalities and the new performance framework. Although the aims of these initiatives to strengthen ESIF performance are important, their efficacy is still open to debate and they have made the overall burden on programme authorities more pronounced

In July 2017 the HLG on Simplification made 12 recommendations on controls and audits for post-2020 (see Table 5), which were part of a wider set of conclusions that included recommendations also on the streamlining of the shared management system, of legislation and guidelines, and of the rules across different funds.

for-policymakers-for-post-2020; Committee of the Regions (2016) Simplification of the implementation of Cohesion policy. Final Report, April 2016.

77 European Court of Auditors (2017) Opinion No. 1/2017 concerning the proposal for a Regulation of the European Parliament and of the Council on the financial rules applicable to the general budget of the Union and amending Council Regulation (EC) No 2012/2002, Regulations (EU) No 1296/2013, (EU) No 1301/2013, (EU) No 1303/2013, (EU) No 1304/2013, (EU) No 1305/2013, (EU) No 1306/2013, (EU) No 1307/2013, (EU) No 1308/2013, (EU) No 1309/2013, (EU) No 1316/2013, (EU) No 223/2014, (EU) No 283/2014 and (EU) No 652/2014 of the European Parliament and of the Council and Decision No 541/2014/EU of the European Parliament and of the Council Revision of the 'Financial Regulation' — Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 (OJ L 298, 26.10.2012, p. 1), OJEU C 91/1, 23.3.2017, https://www.eca.europa.eu/Lists/ECADocuments/OP17_01/OP17_01_EN.pdf.

78 Davies S (2015) 'Is simplification simply a fiction?' *IQ-Net Thematic Paper* 37(2), European Policies Research Centre, University of Strathclyde, Glasgow; EPRC (2016) 'The Simplification of EU Cohesion policy: Problems and Priorities for Change', *IQ-Net Briefing*, January 2016, European Policies Research Centre, University of Strathclyde, Glasgow; Bachtler J and Polverari L (2017) *Building Blocks for a Future Cohesion policy – First Reflections, Report to the European Parliament*, Directorate General for Internal Policies, Policy Department B: Structural and Cohesion Policies.

Table 4: HLG recommendations for control and audit post-2020

Fewer rules	Where there is evidence that practical implementation of specific rules is difficult, for example, in the context of net revenue-generating projects, financial instruments, or eligible costs, they should be replaced by off-the-shelf solutions, such as flat rates, unit costs or lump sums.
Less micromanagement and more reliance on national rules	The system should be very flexible to be able to accommodate existing national checks rather than trying to define 'one-size-fits-all' rules. It should prioritise solutions which are embedded in national rules, rather than creating ESIF-specific checks parallel with or in addition to national systems.
EU auditors should refrain from directly controlling individual projects	A model should be considered whereby the Commission focuses on system audits while control of expenditure remains the sole responsibility of the Member States, in line with the principles of subsidiarity and shared management.
Avoiding parallel control structures	When it is proven that national rules (not just restricted to EU funds) function properly, there is no need to require a re-check by the authorities responsible for ESIF (e.g. in the context of public procurement, environmental acquis and state aid).
Scope of audit proportional to risk through 'smart differentiation'	Either more reliance is put on national systems, or a genuine reduction of audit obligations should be based on ex-ante validation (designation, accreditation or system audit, but still founded on common and shared criteria to ensure equal treatment).
Increase legal certainty	Optional early system audit to confirm the functioning of the systems, which would not only verify the existence of procedures, but could include a 'pilot phase' to test their implementation.
Focus on preventive measures	Involvement of auditors before approval of guidelines, better and regular communication between the Commission, audit and MAs to discuss recurring issues and disagreements, preparing template documents (e.g. for public procurement) for use in projects.
Shift towards risk-based auditing	Reducing the audit burden on beneficiaries, public authorities with proven capacity (or another effectiveness measure), and a shift towards performance-based auditing where the project result is of key importance in the audit trail and implementation is of secondary importance.
Single audit+	Raising the thresholds under which any project could be audited only once. 'Higher-level' audits should be related to re-performance, with the beneficiary not affected by any additional future findings. The requirements connected to each individual payment, or required annually, should be replaced by risk-based verifications which take place just once in the project's lifetime and are limited in scope.
A faster and more transparent conflict-resolution mechanism	The necessary procedure to reach the conclusions often takes too long. Commission should consider setting up a functionally independent appeal committee, taking into account experience from the EAFRD and possibly limiting its use to issues with significant financial impact.
More differentiated approach to errors and fraud	A new definition is needed which clearly distinguishes between fraud and errors, as well as making a distinction between the gravity of errors. The justification for the 2% materiality threshold should also be reconsidered, particularly for innovative, small and cross-border projects, or which are implemented by small organisations.
Preventing gold-plating	The application of all procedures which are not described either in the regulation or guidelines should not be considered automatically as a breach of the rules and should be assessed on a case-by-case basis.

Source: HLG (2017) *Final conclusions and recommendations of the High Level Group on Simplification for post 2020*, http://ec.europa.eu/regional_policy/en/information/publications/reports/2017/esif-simplification-hlg-proposal-for-policymakers-for-post-2020

All of these statements and studies highlight general questions and some specific issues to be considered in balancing the objectives of simplification and sound financial management post-2020. The key underlying theme across all these different topics is the **need to reduce**

the costs of administering the funds while retaining the positive trend in the reduction of error rates.

A key question is whether and how a differentiated approach could be designed that moves away from the one-size-fits-all model of shared management and which recognises that different models may be appropriate for different contexts. In the area of financial management, audit and control, there are arguments for a fundamental review of the way Cohesion policy operates and the need to recognise differences in institutional and administrative structures and capacities across MS. This could involve significantly fewer controls where administrations can prove that they are reliable and strong audit authorities are in place, potentially relying only on national rules in these cases (as under the 'single audit approach'). A fundamental issue is which criteria should be used to justify the use of devolved management in some MS. Current research is exploring the possibilities of differentiation for post-2020 Cohesion policy, covering a range of options (scale of funding involved, quality of government etc.).[79] An alternative to the possibility of differentiated approaches would be pushing MSs to implement fewer, larger programmes, as a way to streamline administration and costs.

Another issue concerns the extent to which harmonisation of rules across ESIF can increase simplification. Here, the debate concerns the move toward a single set of rules for shared management funds. It should be recognised that introducing differentiation and harmonisation into the management of Cohesion policy will not be easy and might well cause unintended consequences. In this respect, it is vital that there is certainty over the status, interpretation and application of Commission guidance, and whether it should be treated as advice, as 'soft law', as 'best practice' or as a form of regulation. A challenge in this approach would be to continue to accommodate the needs of different types of beneficiaries and projects, and of ETC programmes.[80]

Specific issues in the debate include:[81]

- **The role of compliance and performance audits**. The use of performance audit as a means of producing insights on the efficiency and effectiveness of programmes and develop recommendations for simplification has been noted in the literature.[82] A key issue is how these benefits can be realised, in tandem with a continued focus on compliance that provide crucial assurance to MA and EU authorities.[83]

- **Simplifying (or indeed eliminating) the designation procedure (Art. 124 CPR).** The process of designating Managing Authorities and Certifying Authorities has been particularly complex, long and painful for programme authorities[84] and it has had an impact on the timetable of programme launch. At the time of writing, after almost four full years from the start of the programme period, there are still MAs that have not yet been formally designated. Options being debated include: removing the whole procedure in future, introducing conditional/partial designation, merging

[79] Bachtler J and Mendez C (2016) *Op. cit.*
[80] *HLG (2017) Op. cit.*
[81] Committee of the Regions (2016) *Simplification of the implementation of Cohesion policy Workshops on 27 January and 10 March 2016*, Final Report.
[82] T'Joen L (2016) 'Performance auditing: Current methods and future prospects', *Journal European Court of Auditors*, No. 9 September 2016.
[83] Ibid.
[84] Davies S (2016) *Op. cit*.

functions between the independent audit body and audit authority; and, introducing shortened designation procedure in case of satisfactory previous audit results.

- **Recognising the proportionality principle in the functions of the Audit Authority (Art. 127 CPR)** e.g. through risk-based methods of sampling for controls; smaller projects audited only once before closure; scope to reduce controls & audit intensity.

- **Simplifying audit of Financial Instruments (FIs)**, though how to achieve this is still open to question. Multi-level audits and controls of FIs have been particularly complex and burdensome for programme authorities.

- **Increasing the materiality level of errors** (e.g. from to 2%, as under Art. 28(11) of Commission Delegated Regulation (EU) 480/2014, to 5%) in order to reflect the balance between the administrative costs incurred in efforts to reduce the level of errors and the savings gained from improved financial control.

- **Simplifying statistical sampling**. Audit work has become more demanding, notably through the requirement that AAs submit opinions based on a statistically representative (and thus larger) sample of checks. More flexibility for random statistical sampling could be introduced in case of operations covering small size populations.

- **Standardising and simplifying national legal verifications** (common public procurement checklists, risk assessments, etc.).

- **Extending 'off the shelf' simplified cost options (Art. 67 CPR)**. The Commission could seek to establish more 'off the shelf' simplified cost options through delegated regulations in order to decrease the administrative burden and to help increase legal certainty for the MAs.

Figure 7 below, provides a summary of the views of the actors interviewed from the MAs and AAs of the seven programmes selected for our investigation on the main simplification proposals currently being discussed, and in some cases introduced for 2014-2020, in relation to control and audit functions, namely:

- **The increased proportionality of control and audit activities**, i.e. whether there is real scope to reduce control and audit intensity based on EU contribution, risk-based methods of sampling for controls, auditing of smaller projects only once before closure and similar;

- **Rationalisation of tasks and responsibilities assigned to different authorities**, i.e. the scope to assign MAs the responsibility of carrying out proportionate and effective antifraud measures, based on risk assessment, and the possibility for programmes with financial allocations less than EUR 250 million to subsume the AA within the same authority that also acts as MA;

- **The simplified designation of audit and control systems**, i.e. the national designation instead of Commission approval of management and control systems (review by the Commission only in specific cases);

- **A shift from multiple layers of controls to cross reliance on audit, assessment or authorisation, and the harmonisation of reporting requirements,** including increased reliance on one single audit, assessment or authorisation, when conditions are met to be taken into account in the EU system; the increased reliance on implementing partners' own procedures once these have been positively assessed (i.e. EIB, IMF, promotional banks, agencies, NGOs etc.); and the signature of financial framework agreements with long term partners to improve harmonisation of audit, reporting etc.;

- **Easing audit burden at closure**, for example via annual declarations of assurance;

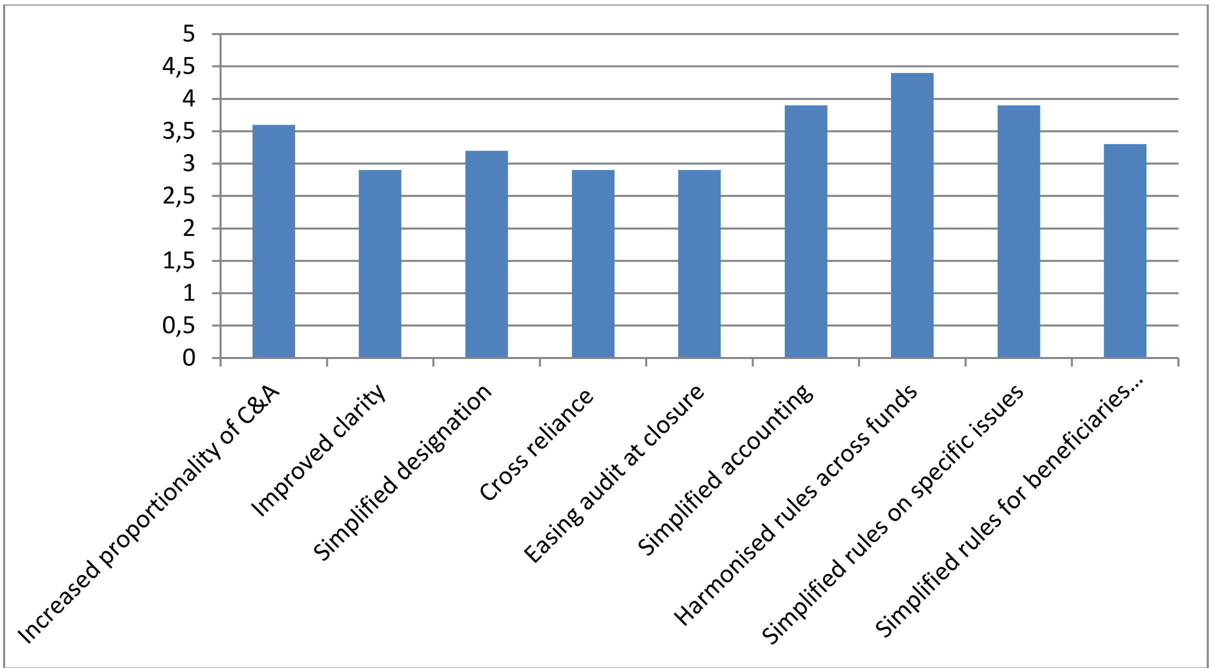
- **The introduction of harmonised rules across funds**, as anticipated in Title VIII of the Omnibus regulation, allowing easier combination of multiple funds in a single programme;

- **The introduction of simplified rules on specific issues**, such as flat rates for revenue generating projects or simplified audit arrangements for Financial Instruments; and,

- **The simplification of rules for beneficiaries in relation to grants**, for example the removal of non-cumulative award check for low-value grants and of the non-profit principle; simpler rules for the valuation of the 'contribution in kind', the ability to provide grant awards without calls for proposal under specific conditions, and the provision of simplified forms of grants (again, as anticipated by the Omnibus regulation proposal, Title VIII).

Interviewees were asked to rate the perceived utility of each measure on a scale 1 (not useful) to 5 (extremely useful), and to discuss the reasons for their assessments.

Figure 7: Overall assessment of utility of different simplification measures



Source: Case study research.

As Figure 7 shows, the measure considered as, prospectively, **the most useful is the harmonisation of rules across funds**. While efforts in this direction have already been introduced in the 2013 regulations, according to the interviewees consulted for this study there are still areas of significant inconsistencies across funds, for instance different approaches to using past 'track records' of beneficiaries, identifying those that have had repeated problems with errors in the past. There is a perceived need for alignment of the regulatory requirements of different EU policies. Of particular concern is the way that requirements in different EU legislation are currently combined with ESIF rules, sometimes without clear thematic coherence, which complicates or inhibits smooth, effective realization of ESIF in certain fields. For ETC programmes involving third countries, this harmonisation effort should also apply to IPA.

More streamlined accounting, simplified rules for beneficiaries on grants (where applicable) and more proportionality in audit and control were also judged as very desirable measures. In some cases, interviewees recognised that steps in the right direction have already been taken (e.g. in relation to the harmonisation of rules across funds and the use of SCOs) and need to be pushed further.

Perspectives change when the same questions are examined from the point of view of MAs and that of AAs (see Figures 8 and 9). AAs are consistently more sceptical about aspects involving a shift to performance/risk-based controls and the introduction of proportionality in control and audits. Auditors at EU and national levels expressed doubts about the feasibility and utility of the approach, stressing:

(i) **the risks entailed by a shift to performance audit**, i.e. that rules will not be strictly adhered to, including in relation to public procurement or State aids, and that error and irregularities might increase;

(ii) **the positive role that compliance audits have** in enhancing the legality and regularity aspects of programme delivery, and the learning or capacity-building function that compliance audits have in raising awareness among MAs and beneficiaries of the need to comply with rules (e.g. on State aids, public procurement);

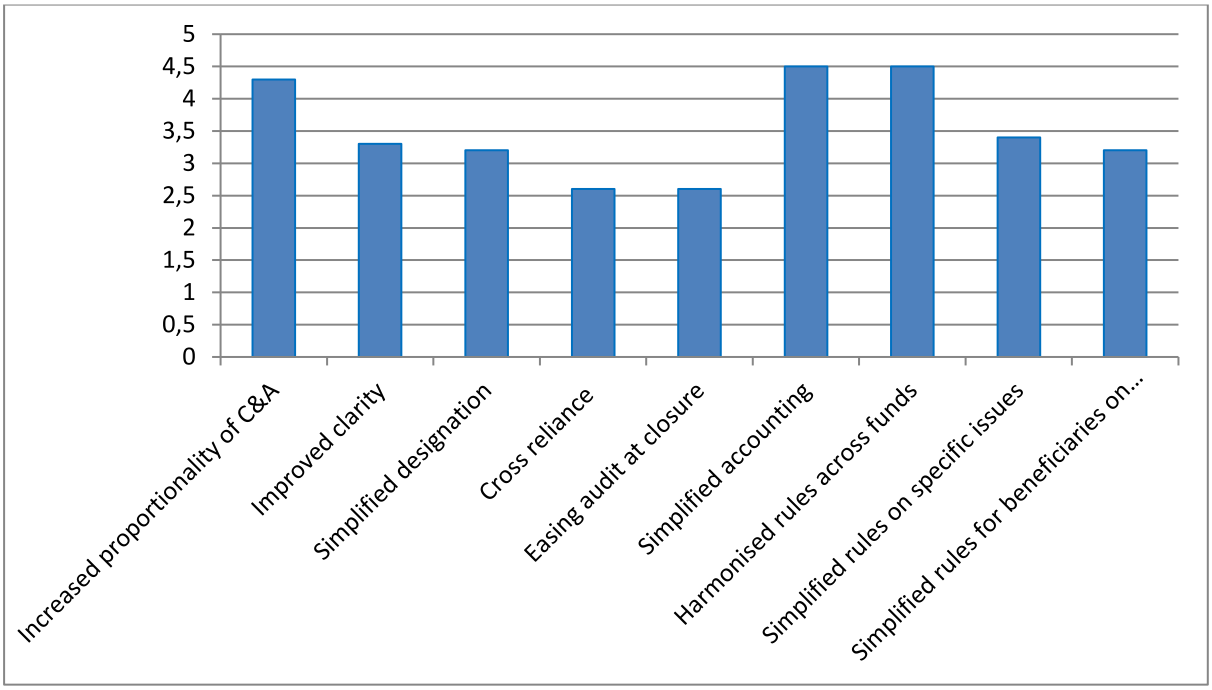
(iii) the scope of the change that would be involved by a shift to performance oriented audit, as a move to a performance audit system would mean **a fundamental change to the current model**, i.e. a shift in paradigm that would require altogether different professional profiles and/or extensive (re)training efforts and gearing-up times;

(iv) **the importance of statistical representativeness in sampling methods** for compliance audits. There has been debate on replacing statistical representativeness with random or risk-based representativeness in order to ease the administrative burden of audits. However, auditors emphasis that statistical representativeness is essential to guarantee adequate audit coverage (and thus confidence in the auditing work);

(v) the **difficulty to link control and audit activities to the size of projects** since 'relative size' differs by type of projects and fields of interventions;

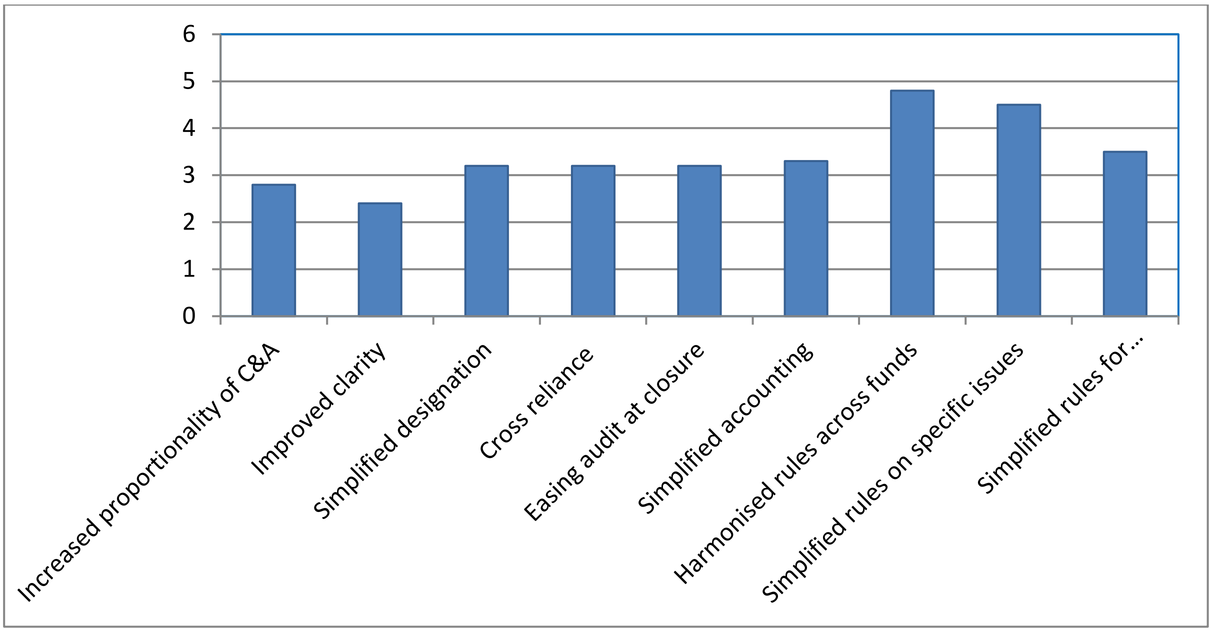
(vi) that while **the single audit approach is seen as very valuable, a necessary precondition is the creation of standard methods** to be utilised by all involved, and of a basis of trust across different institutions and types of actors.

Figure 8: MA case studies - views on simplification options



Source: Case study research.

Figure 9: AA case studies - views on simplification options



Source: Case study research.

Specific issues can be raised in relation to FIs and ETC programmes. With regards to the former, interviewees tended to agree with previous research findings that FIs increase the complexity of programme implementation, require specialist skills and present specific challenges with regards to control and audit.[85] FIs make up a significant part of the complexity of audit work and place substantial demands on the capacity and competences of

[85] Bachtler J, Mendez C and Polverari L (2016) 'Ideas and Options for Cohesion policy Post-2020', *IQ-Net Thematic Paper 38(2)*, May 2016, European Policies Research Centre, University of Strathclyde, p. 56.

AA staff: they have to possess knowledge and skills in dealing with complex FI-related issues. The data transmitted by national authorities to the Commission on FIs funded by the ERDF and ESF are in some cases incomplete and inaccurate, and can present errors, for example in relation to funding ineligible projects or costs.[86]

ETC programmes present specific challenges, related to the types of projects funded (mostly immaterial) and the different institutional settings involved that can condition implementation, especially when the programmes involve non-EU countries (for example in the area of State aids where national legislations in countries outside the EU are not aligned with the EU framework).

[86] European Court of Auditors (2016) *Annual Report of the Court of Auditors on the implementation of the budget concerning the financial year 2015, together with the institutions' replies*, OJEU 2016/C 275/01.

6. CONCLUSIONS AND RECOMMENDATIONS

6.1 Identifying complexity

- **The current system has been working effectively in terms of its ability to drive errors and irregularities down. The problem is essentially one of the costs incurred in the process of financial control and audit versus the benefits this produces.** While the costs of the current control and audit system are problematic, there is still a need for checks to be carried out to ensure that all applicable rules are respected (including horizontal rules such as those on state aid and public procurement rules).

- **At the present moment, significant simplification has yet to be realised.** A significant portion of the complexity of administering (and checking) ESIF relates to rules that are outside the sphere of Cohesion policy (e.g. relating to state aid and public procurement).

- **An important challenge is represented by inconsistent and unstable rules between different EU instruments.** The lack of stability and consistency in regulatory frameworks generates significant complexity. There is unfair competition between ESIF and other EU instruments, due to the different levels of complexity in instruments under shared and direct management (e.g. complexity involved in implementing infrastructure projects under ERDF is much greater than under the Connecting Europe Facility, and the use of Financial Instruments under ESIF is more complex compared to EFSI).

There are also specific issues within ESIF related to control, audit and the need for assurance.

- **Management verifications, particularly administrative verifications, create significant complexity for MAs and beneficiaries.** Providing assurance is challenging with complex regulations (e.g. public procurement, state aid), unclear guidance, and severe sanctions possible on the level of projects (net corrections for beneficiary) and on the level of programmes (allowed materiality only 2%). The cascade of controls results in legal uncertainty for beneficiaries.

- **The designation process is a new task for programme authorities. While it was intended to simplify the procedures behind programme launch, it has created complexity.** MAs see the importance of the process in strengthening assurance but it has been onerous to carry out.

6.2 Assessment of key simplification measures

- **Designation**. One aim of the designation process was to give increased scope for simplification with MS given the option to carry out the process without direct Commission review. However, many MS opted to have a ‘heavier’ approach to designation due to concerns that future audits and controls would identify errors.

- **Annual reporting has benefits and drawbacks in terms of financial control and simplification.** The fact that regulatory provisions for 2014-20 require that Member State’s reporting on financial corrections is now integrated into the annual assurance package and examined by the respective audit authorities significantly strengthens the Commission’s position on protecting the EU budget from irregular expenditure in particular through net financial corrections. There are also advantages to 'annual closure' from the perspective of simplification and increased assurance. Potentially, it reduces the burdens associated with a long retention period of documents for individual beneficiaries and the risks for errors associated with the loss of the audit trail. This approach should also reduce the administrative burden and complexity faced by programme authorities and beneficiaries during closure processes at the end of programme periods. However, this 'rolling closure' process presents some challenges for programme authorities. The MA the CA and the AA need to work jointly to agreed deadlines to clear accounts. Also annual clearance of accounts creates significant workload at the end of each year. Document retention periods have been reduced to assist beneficiaries, but are now more complex, with dates varying by Fund and size of project. This approach is seen to create an additional administrative burden, as well as an increased risk of error (also because many beneficiaries receive both ERDF and ESF funding, where document retention periods differ).

- **Risk-based methods of sampling for controls.** MAs tend to see this change as beneficial, at least in principle, although there are concerns in practice and calls for better and more consistent sampling. AAs underline the importance of retaining statistical sampling to maintain the necessary level of trust on the audits realised.

- **The 'Single Audit' model is seen by programme authorities to have potential in terms of simplification.** However, it is still being rolled out and implementation is challenging and relies on the capacity of programme authorities and beneficiaries, including the quality of IT systems. There is a need for more clarity on how and when an auditor can rely on existing findings.

- **Simplified cost options are welcome but need to be further developed.** The use of SCOs has resulted in genuine simplification in some cases by making management verifications less cumbersome. Audit Authorities can build on this and audit less, error rates become lower and the Commission sees more programmes and operations as low risk and visits less. However, take up of this option is still uneven. Some MS and programme authorities do not have the capacity to develop methodologies for the use of these SCOs. There are 'off the shelf' options available from the Commission, but the fear persists in MS and programmes that they will be open to controls, audit and corrections in the future unless they use the full, mainstream approaches.

- **'Once only' audit for small operations**. Is useful in principle but a potential risk is, for example, that the threshold for "smaller project" be set so high that most projects do not qualify. Project size also varies across types of project and programme; there may need therefore to be different thresholds for different types of 'small' projects. Thus, while further tailoring of project audits should be considered, this may more usefully be linked to using a risk-based approach related to the nature of the beneficiary or involving a lighter approach for applicants with a proven track record with ESIF-funded projects, rather than simply project size.

6.3 Recommendations for post-2020

The research highlights a number of general principles and practical recommendations that should be borne in mind by stakeholders from EU and MS levels involved in designing future reforms with a view of reducing complexity and improving ESIF performance, while continuing to drive errors and irregularities down. It should be noted that striking a balance between these, partly conflicting, principles is challenging. In deciding the emphasis to be placed on different principles, clear choices have to be made on the ultimate goals of simplification and who should be the main target of such efforts (e.g. beneficiaries, programme authorities).

General principles

- **Harmonisation.** Genuine simplification must begin with greater harmonisation of rules across Commission services, funds and instruments. The complexity of audits and control is intrinsically linked to the complexity and clarity of the rules that the actors in charge of controls and audits check. Any simplification has to start with this, with renewed efforts for greater harmonisation of rules. This highlights the role of EU initiatives in this field, including the Better Regulation AGENDA and the REFIT Platform.

- **Stability.** More stability from one programme period to the next and better predictability for programme authorities and beneficiaries would simplify implementation, cut the times and costs of adaptation, and reduce the risk of errors and irregularities. For instance, a recent Commission study on the take-up and effectiveness of financial instruments called for greater regulatory stability given the complexity of the rules and their revision on a seven-year cycle.[87]

- **Brevity.** There should be single texts, made available to programme authorities in a timely manner, rather than a proliferation of rules and interpretations. This would enable better coordination between different actors and the timely identification of administrative capacity gaps to realise necessary capacity building activities.

- **Trust and capacity building.** There are numerous examples where the Commission has tried to introduce simplification by increasing the scope for flexibility and proportionality in control and audit fields (e.g. the Single Audit model, SCOs, the option of 'lighter' designation procedures). However, limited take up of these options across MS and programmes can be explained by lack of trust and/or capacity. Capacity-building and trust-building at beneficiary level will take some resources from the Commission and programme authorities but this can be seen as a one off investment that will create bottom up benefits for all levels in the longer term. An example of this is the use of SCOs where there are examples of Commission efforts to build trust has seen significant take up and an accompanying decrease in error rates.

- **Flexibility and differentiation**. Different beneficiaries have different capacities, different operations involve various processes and programmes vary in terms of their budget, thematic scope and implementation arrangements. Regulations and guidance should not respond to this through micromanagement and the accumulation of myriad requirements based on specific experiences and problems. Rather, there should be

[87] Wishlade F, Michie R, Robertson P and Vernon P (2017), *Improving the Take-up and Effectiveness of Financial Instruments,* Final Report to European Commission.

flexibility to adapt regulations and guidance to suit different contexts. However, objective criteria on which to build this flexibility must be found. The key challenge is how to set objective criteria on which differentiation can be based, including on financial management issues. For instance, the error rate or level of irregularities would in theory be a strong criterion: fewer irregularities would indicate stronger capacity and less need for control. However, it is important to note some challenges in using this as a simple criterion. The level of irregularities can be conditioned by the level of resources available for Cohesion policy audit and the capacity of AAs: a high level of errors may reflect good detection. Moreover, different types of interventions incur varied levels of risk (e.g. programmes containing a high share of innovative projects may be associated with more errors).[88]

- **Appraisal,** to avoid unintended consequences. A number of valuable simplifications (e.g. the use of SCOs) have already been introduced but their benefits has been undermined by new requirements which generated further complexity. To avoid this, it is paramount that the impact on administrative cost and burden of any reform proposal is carefully appraised and that this impact is compared with the benefits associated with retaining the current rules and systems.

- **Timing** is an issue when developing proposals and ideas. Commission authorities, including audit authorities, are being asked to make proposals for the future over the next few months. However, due to delays in programme implementation, they have little evidence to assess what is and is not working. Thus, EU and national authorities should take a longer-term view in appraising what works and what doesn't. In the past, sometimes rules were discontinued in one programming period only to be reintroduced in the next, without serious reflection about the reasons behind their discontinuation (e.g. multi-fund programmes, performance reserve).

- **Role of the Commission**. Continued pursuit of simplification initiatives, reviewing and revising current regulations, including the HLG on Simplification, 'Better Regulation Agenda' and the REFIT Platform and support of capacity-building initiatives in MS to strengthen simplification (e.g. in the take up of SCOs), removing unnecessary requirements and not rewriting new rules as beneficiaries learnt them over the years.

- **Role of ECA.** The ECA is crucial in balancing the need for legality and regularity of expenditure with the need for simplification. Current initiatives to strengthen cross reliance with the Commission and MS (in terms of the results of controls, methodological approaches etc.) should be further developed. Nevertheless, the autonomy of the ECA remains paramount; the ECA is not part of the ESIF system and their opinion is independent.

- **Role of the Member States**. It is important that MS play an active part in reducing complexity, for instance through reviewing domestic rules that can have an impact on complexity through 'gold-plating' (e.g. public procurement rules that are more restrictive than EU ones), or through simplification of programme management and

[88] Bachtler J, Mendez C and Miller S (2017) 'Rethinking shared management for Cohesion policy post-2020: Criteria for deciding differentiation in the management of ESIF' *European Policy Research Paper* No. 96.

implementation systems (for example by limiting the multiplication of bodies which is generated by a high number of OPs).

- **The performance orientation.** The spread of performance audit and their use for financial decisions could be further pursued at EU and MS levels. However, this should not come at the detriment of lowering the historical error rate. The ECA could become more involved with MS authorities by presenting performance audit reports before national parliaments more regularly. It could also seek closer cooperation with national audit institutions to harmonize audit approaches, for instance through 'coordinated' audits (e.g. JASPERS performance audit was coordinated between ECA and the Polish Supreme Audit Authority) or 'joint' performance audits where ECA auditors take part in MS performance audits of nationally-funded measures while MS auditors take part in ECA performance audits of similar EU co-funded projects. These proposals need to be considered bearing in mind the remit for the ECA to act efficiently: past experiences of coordination and collaboration with national auditors have proven in some cases very resource-intensive. Further, it should be noted that performance audits have different goals altogether compared to financial and compliance audits, thus putting the two on the same level may be misleading. The value of financial, compliance and performance audits is clear and the challenge is to coordinate audits to minimise the demands on EU and MS participants.

- **Accountability.** In the case of EU funds operating under the 'shared management' principle, there is a need for mechanisms to provide assurance that the information is accurate and reliable. Thus, ESIF control and audit procedures are part of an accountability chain through the various checks, verifications, controls and audits of financial management, control and audit (by MS and programme authorities, the European Commission and the ECA). This mix of internal controls and audits, and external audits has led to a reduction in error rates but it is also important to recognise wider contributions to transparency and improving understanding of who is accountable for what outcomes. The strength of this accountability chain relies on the strength of its individual components at all levels. If these mechanisms do not exist, or do not perform effectively and efficiently, the accountability chain is broken.

Specific issues

- **Reconsider the designation procedure**. The principle of proportionality could be valuable here, targeting systems that are or have recently been in flux for full designation process but applying lighter approaches for established, stable systems. However, in reality Member States prefer to have the 'heavier' approach to designation, due to concerns that future audits and controls might identify errors and that they would be punished. Thus, Member States are reluctant to take on responsibilities that would decrease complexity in this area. Institutional stability across programme periods would alleviate this problem.

- **SCOs have proven useful and should be extended**. However, more clarity should be provided on aspects that relate to their application, (e.g. calculation of unit costs and application of public procurement rules). There needs also to be procedures in place to ensure that simplified controls on some aspects are not counterbalanced with additional controls on other elements of the same projects. In this context, a useful rule highlighted in the case study research is contained in Article 14(i) of the ESF Regulation. It allows for standard scales of unit costs and lump sums to be set out in a delegated act. These are different from 'classical' simplified costs as specified under

Article 67 CPR. The Commission can adopt Delegated Acts concerning the types of operations covered, the definitions of the standard scales of unit costs and lump sums and their maximum amounts, which may be adjusted according to the applicable commonly agreed methods, taking due account of experience gained during the previous programming period. Essentially, Article 14.1 a way to pre-approve Simplified Cost Options, giving legal certainty to MS/regions that are wary of getting the methodology wrong. This gives the possibility for the Commission to define by delegated act standard scales of unit costs and lump sums and the possibility for MS to apply its own accounting practices with the beneficiary.[89] In this context, it should be noted that the draft Omnibus Regulation proposes the increased use of SCOs, that the responsibilities of MAs regarding the verification of expenditure when simplified cost options are being used should be specified in more detail. The regulation also proposes that Delegated Acts should be used to empower the Commission to define the standard scales of unit costs or the flat rate financing, the fair, equitable and verifiable method on which they may be established, and the financing based on the fulfilment of conditions related to implementation or the achievement of programme objectives rather than on costs.

- **Annual reporting presents benefits, but further streamlining is needed.** While the principle of annual reporting is appreciated by programme authorities, because it offers a more structured approach to creating assurance over the programming period and addresses some of the complexity encountered at programme closure, it is challenging for programme authorities to implement. Further simplification should include the timely publication of Commission guidelines, so that IT systems can be planned to collect the right data from the start, and the elimination of duplications or overlaps between this task and the Annual Control report prepared by the Audit Authority.

- **Dedicated rules and support for specific types of programmes and operations.** There has to be dedicated support and rules for beneficiaries and Managing Authorities in setting up and implementing control and audit arrangements for specific types of programme and operation e.g. ETC, FIs and revenue-generating projects. For specific types of programme and intervention there has been a steady accumulation of rules and guidance over programming periods. This has reduced legal certainty and caused confusion. While there have to be different control mechanisms for different types of operation, and not a ‘one size fits all’ approach, this may require the introduction of softer governance arrangements but this in turn requires trust. For instance:

- **For FIs**, fieldwork research carried out for this study identified the following options to deal with such specific complexity: separating out FIs in dedicated priorities (or possibly programmes, where a critical mass might justify this); setting minimum allocations for the funds to be established (e.g. EUR 200 million); standardising the structures of funds. Legal certainty continues to be a problem in this area, sometimes

[89] 32nd meeting of the Expert Group on DA and IA for the ESI Funds, Fiche No 37B 14(1) ESF Reg, Brussels, 15 January 2016.

causing friction between MAs and AAs; thus timely, targeted and clear-cut Commission guidance is also seen as crucial in the future.[90]

- **For ETC**, special exemptions or differentiation of the rules applicable to these programmes could both simplify management and limit the risk of errors and irregularity. The use of flat rates, for example, is discouraged by the current limit of 20% of projects' costs. This limit is too low for the type of projects implemented in ETC programmes, which are largely concentrated on staff costs and acquisition of external expertise. Thus specific rules should be adopted in this specific context. Special consideration should be given to the impact of state aid rules on this type of programme. State aid is major source of complexity but the impact of ETC programmes on markets is minimal. State aid responsibilities are very national and are not easily adapted to the multinational composition of projects.

[90] Bachtler J, Mendez C and Polverari L (2016) 'Ideas and Options for Cohesion policy Post-2020', *IQ-Net Thematic Paper 38(2),* May 2016, European Policies Research Centre, University of Strathclyde, p. 28-31.

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ANNEX: LIST OF INTERVIEWEES

3 senior representatives of European Commission

DG Regio, Better Implementation Unit

DG Regio, Coordination, Relations with Court of Auditors and OLAF

DG Employment, Social Affairs and Inclusion, audit and shared management.

7 senior representatives of European Court of Auditors.

15 senior representatives of MAs and AAs, from 7 case study OPs.

This study assesses the relationship between two components of European Structural and Investment Funds – control and audit systems, and simplification measures designed to reduce the complexity of implementation – and explores how this relationship conditions performance. It sets out financial control and audit systems and tasks in 2014-2020, and assesses the causes of complexity before exploring how issues are being addressed in the simplification agenda. The study reviews the treatment of control and simplification in the post-2020 debate before drawing together conclusions and recommendations for ESIF stakeholders.

PE 601.972
IP/B/REGI/IC/2017-051

Print ISBN 978-92-846-2358-8 | doi:10.2861/2854600 | QA-02-18-170-EN-N
PDF ISBN 978-92-846-2659-5 | doi:10.2861/524513 | QA-02-18-170-EN-C